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Professor H.A. Innis



ROYAL COMMISSION ON TRANSPORTATION

Tuesday, March 21, 1950

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO  
TUESDAY  
MARCH 21, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN  
HAROLD ADAMS INNIS - COMMISSIONER  
HENRY FORBES ANGUS - COMMISSIONER

-----  
G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary  
-----

COUNSEL APPEARING:-

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N.J. MacMillan		
C.F.H. Carson, K.C.	}	Canadian Pacific Railway
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I.D. Sinclair		
C.D. Shepard	)	Province of Manitoba
M.A. MacPherson, K.C.	}	Province of Saskatchewan
F.C. Cronkite, K.C.		
J.J. Frawley, K.C.	)	Province of Alberta
F.D. Smith, K.C.	}	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade.
J. Paul Barry	)	Province of New Brunswick
J.O.C. Campbell, K.C.	}	Province of Prince Edward Island

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Ottawa, Ontario,  
Tuesday, March 21, 1950.

MORNING SESSION

T. H. COOPER, RECALLED

EXAMINATION BY MR. O'DONNELL (Cont'd):

MR. O'DONNELL: May it please the Commission, yesterday Dr. Innis asked what the explanation was with respect to the table on page 22 - that is table one, I believe, of Exhibit 214 - as to the fact that the net revenue in 1923 was \$21,123,544, and that in 1924 the net revenue was \$17,000,000, and pointed to the fact that net income available to pay fixed charges was \$20,000,000. We have had a little table prepared which I think we might produce as Exhibit 243. It is entitled comparison of income debit and credit accounts for the years 192 compared with 1923, which I think sets out the information and possibly is self-explanatory.

EXHIBIT NO. 243:	Comparison of income debit and credit accounts, 1923 and 1924.
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Now I should like to turn to a new subject, the matter of the Securities Trust Act, reference to which is set out in the main submission, Exhibit 214, at pages 181 to 184. It is to be found there under the heading, "Section 3, The Canadian National Railways Capital Revision Act, 1937", which for the purpose of the record is 1 George VI, Chapter 22, Section 12 and following of the said act and Schedule A dealing with the Securities Trust Act.

Q. Now, Mr. Cooper, would you tell the Commission briefly for what purpose the Canadian National Railways securities trust was created?

A. The trust was an arrangement incidental to the 1937 Capital Revision Act. The government had agreed that



1990	1991
1992	1993

4001

loans for deficits should be cancelled, that all unpaid interest should be cancelled, and that government loans which had been made for capital purposes should be converted into equity capital. The various corporations, the Grand Trunk, the Grand Trunk Pacific, The Canadian Northern and the Canadian National Railway Company, were indebted to the government for very considerable sums of both principal and interest. These amounts then appeared as liabilities on the system balance sheet. It was desired that as far as the railway system balance sheet was concerned <sup>the</sup> loans for deficits and all unpaid interest should be eliminated. At the same time it was intended that the four debtor corporations should not be freed from their liabilities in respect of principal and interest referred to.

To some extent the claims of the government ranked ahead of other obligations of the companies, <sup>four</sup> and certainly they ranked ahead of the common shares of some of the subsidiary companies in which the public had a minority share interest.

The problem therefore was to make an arrangement which would relieve the railway system of the liabilities in question but which would not relieve the separate corporations which comprised the system. The arrangement decided on was the creation of a trust corporation to which the government transferred its claims against the debtor corporations in exchange for <sup>the</sup> capital stock of the trust. There was no relief to the debtor corporations but the creditor became the trust instead of the government. The government's ownership of the claims became indirect, that is, through the trust.

THE CHAIRMAN: Q. Pardon me; did you say the creditor became the trust?

A. Yes, sir. The four debtor corporations were then indebted to the trust instead of directly to the government. The government's ownership of the claims became





indirect, that is, through the trust, instead of being directly against the corporations themselves. The trust was declared in the legislation to be a corporation comprised in the Canadian National Railway System. This meant that one system company, namely, the trust, carried the claims as assets, other system companies carried the claims as liabilities, and on a consolidation of accounts <sup>the</sup> assets and liabilities wash themselves out.

The capital stock of the trust was then owned by the government. The ledger value of its shares was fixed initially at the amount of government loans used for capital purposes, namely, \$270,037,437. This capital stock liability was of course included on the railway system balance sheet as equity capital against which there was a corresponding asset account in the public accounts.

It was under this arrangement that the loans for deficits and claims for interest were purged from the system balance sheet, but nevertheless they are still kept alive on an intersystem basis.

MR. O'DONNELL: Q. Mr. Cooper, would you tell the Commission briefly what the securities trust is? My understanding is it is somewhat of an accounting device. You might explain it to the Commission.

A. The Securities Trust, as stated in the main submission, is a corporation created by Section 12 of the Capital Revision Act. Its entire capital stock is held by the Minister of Finance on behalf of His Majesty. There are five trustees, three representing the government and two representing the railway. The government trustees are the Deputy Minister of Finance, the Deputy Minister of Justice and the Deputy Minister of Transport. The railway trustees are Mr. Donald Gordon, Chairman and President, and myself. The Capital Revision Act stipulates under what conditions





the initial stated value of <sup>the</sup> Trust shares may be increased or decreased. It may be increased by capital gains and by surplus earnings retained by the railway. It may be reduced by capital losses which are excluded from cash settlements on deficit account.

The initially stated value of \$270,000,000 plus was increased by \$112,502,061 representing surplus earnings of the railway during the war years 1941 to 1945. It was also increased by capital gains amounting to \$19,105,651 representing gains on the redemption of repatriated securities at <sup>a</sup> price less than their par value. The initial<sup>a</sup> stated value has also been reduced by \$23,127,015 representing capital losses, chiefly line abandonments. The present ledger value of the shares of the trust is \$378,518,135, so that since the trust was incorporated the value of the shares has increased by about \$108,000,000. That is the book value of the shares.

This amount is carried <sup>liability</sup> as equity capital by the railway, and in 'a' corresponding asset account in public accounts. There have been no transactions affecting the ledger value of the shares since 1947.

Q. What is it that you propose to do, and what will the result be if it be done?

A. What is now proposed is that ownership of the shares of the trust shall be transferred by the government to the railway company in exchange for an equal number of railway company shares having the same ledger value. If this is done the railway's ownership of the shares as an asset account would be offset in the consolidated balance sheet against the capital stock liability of the securities trust. That is to say, both the asset and liability accounts would be eliminated from the system balance sheet, and the affairs of the securities trust would all be within the family and would not appear on the <sup>system</sup> balance sheet.



The equity capital owned by the government would then all be reflected on the railway balance sheet as capital stock of Canadian National Railway Company. This proposal, if made effective, would consolidate the government's equity in Canadian National into two accounts instead of three. At present there are three accounts: (1) Capital stock of the Canadian National Railway Company; (2) Capital stock of Canadian National Railways Securities Trust, and (3) Capital expenditures by the government on Canadian national railways.

Under the proposal number 2 would disappear.<sup>(4)</sup> The advantage from this arrangement is that it helps to simplify our capital structure. The Securities Trust would not appear, and the capital now represented by the share shares of the trust would be represented by shares of the railway company. The government's ownership would not be diminished in any respect but would be entirely through the railway company instead of being partly through the railway and partly through the trust. Very few people understand the interjection of the securities trust in the capital structure of the Canadian National, and this arrangement would help to a better understanding.

Q. If that be carried out are there any disadvantages to be expected from the making of the change which you propose so far as you can see it?

A. There will be no disadvantages.

Q. Why?

A. The debts of the four corporations will remain exactly as they are, and will still continue to be held by the trust. Transactions affecting the government's equity capital account will continue to require government approval. The collateral securities held by the Trust will continue to be so held subject to release only with the approval of the Governor in Council as required by Section 21 of the Act.

This matter has been discussed with the government





Trustees, referring to the Deputy Minister of Justice, the Deputy Minister of Finance and the Deputy Minister of Transport. While they do not consider they should express their views as to what government policy should be, they are satisfied that the railway shall include the subject in its submission to the Royal Commission requesting the Commission's favourable consideration and recommendation.

Q. I take it these last remarks of yours are by way of a little clarification of the opening paragraph on this matter at page 181 of Exhibit 214. The three government trustees have no objection to your making the suggestion that is now being put forward to the Commission but they make no specific recommendation in the matter?

A. That is correct.

Q. Now, it occurs to me it might be well to produce as Exhibit 244 the last annual report of the Canadian National Railways Securities Trust for the year ended December 31, 1949.

EXHIBIT NO. 244:      Annual report of Canadian  
                             National Railways Securities Trust  
                             for year 1949.

I don't know whether Mr. Cooper feels that any explanatory remarks should be made in connection with it. Have you anything to say concerning it, Mr. Cooper?

A. No, I do not think there is anything further to be said.

Q. Unless someone has some other question of Mr. Cooper on that subject I intend to turn to another.

(page 18651 follows)





Q. Now, Mr. Cooper, Mr. Gordon, the President, on Friday last made submissions to the Commission and I refer to the submission by way of an appropriate adjustment, the \$760 million of interest-bearing obligations held by the Government, that they should be exchanged for equity capital and reflected in the balance sheet as such. Mr. Gordon made a further suggestion for an adjustment, that the Government should acknowledge an indebtedness to Canadian National in the amount of \$300 million to bear interest at 3% until discharged. He went on to say:-

"This would be set up in the accounts of Canadian National as a capital fund to be drawn on from time to time to retire interest-bearing obligations in the hands of the public or for capital additions to the property."

THE CHAIRMAN: Pardon me a moment, you are going back to Mr. Gordon's statement, are you?

MR. O'DONNELL: I don't think your lordship need bother about finding it. It is just by way of drawing to Mr. Cooper's attention the matter to which I am referring.

THE CHAIRMAN: But where is that?

MR. O'DONNELL: On page 15, my lord:-

"As consideration for the acknowledgment of the indebtedness of \$300 million, the Canadian National would issue a commensurate amount of equity stock to the Government."

THE CHAIRMAN: That is paragraph 2 there?



MR. O'DONNELL: Paragraphs 1 and 2 I have referred to, my lord. Then I think Mr. Gordon went on to say, Mr. Cooper, that such a capital fund in his opinion (concurring in by the Board of Directors) is the minimum relief which should be granted to the railway, in addition to the conversion into equity capital of <sup>the</sup> \$760 million held by the Government. What can you say as to that figure of \$300 million?

A. The extent of the relief set out in his statement represents the decision of the President himself. I do not know all the considerations he had in mind in making that decision. I know, however, three of them which are as follows:-

(1) The capital requirements of the Canadian National in the next five years will amount to \$307,869,711. Of this amount \$130,800,000 is for additions and betterments, exclusive of new equipment; \$142,069,711 is for maturing funded debt; and \$35 million is for funded debt which can be called during the period.

(2) Those maturing obligations, including equipment serial payments in the ten-year period 1950-1959 total \$377,333,053.

(3) The relief, comprising interest on Government loans, \$21,798,000, plus \$9 millions (that is 3% on \$300 millions) would be \$30,798,000.

In my evidence at page 18582, I stated that the average annual deficit of the Canadian National Railway System in the 27-year period 1923-1949 had been \$20,808,914;





I also stated at page 18578 that the adoption of depreciation accounting for Canadian Lines rolling stock had increased our expenses. If we had had depreciation accounting throughout the 27-year period the average annual deficit would have been \$25,977,989. I also stated at page 18579 that there is nothing in the results shown in Table No. 4 in respect of the Newfoundland Railway. If we add \$4 million per annum the average annual deficit would be \$29,977,989. That is to say, taking the record of the Company since amalgamation and adjusting to present day conditions with respect to depreciation and the Newfoundland Railway, our average annual deficit would be in close approximation to the relief indicated as necessary. On this basis nothing is available for a return on equity capital, nor does it give the Railway anything to "come and go on".

Q. Now, Mr. Cooper, the President made those two submissions concerning the adjustment of the capital structure, that is, that the \$760 million of interest-bearing obligations held by the Government should be exchanged for equity capital and reflected in the balance sheet as such; and then went on to make the submission that the Government should acknowledge an indebtedness to the Canadian National in the amount of \$300 million. You have this morning explained the submission which is put forward concerning the adjustment of the securities trust, the Canadian National securities trust. You heard the President's submission and since Friday last I asked you to endeavour to draw a short form of balance sheet, a consolidated balance sheet, which would show, applying it to the 1948 results, the situation as it would be if the relief requested were to be put into effect.





I would ask you to produce as Exhibit 245 a document entitled "Canadian National Railways Consolidated Balance Sheet at December 31, 1948" which I understand shows the published results, shows the adjustments which have been suggested, and shows what the position would be as and when revised.

...EXHIBIT 245...filed by : Canadian National  
Mr. O'Donnell : Railways Consolidated  
: Balance Sheet at  
: December 31, 1948.

Q. Now, would you be good enough to explain that Exhibit to the Commission and make such comments as you think appropriate?

A. Exhibit 245 is a condensed consolidated balance sheet at December 31, 1948. In the top half of the statement we show the assets, in the lower half the liabilities. In the first column we show the published amounts, in the second column we show the adjustments which have been proposed, and in the end column we show the position as it would be if these adjustments had been approved and made effective. There are three adjustments. They are noted at the foot of the statement. Adjustment (a): Conversion of Government loans into equity capital, \$760,494,825. By referring to the second column - -

Q. And under the heading "Adjustments"?

A. Yes, in the lower half of the statement it will be noted that the item "Government of Canada Loans" is eliminated by this adjustment and a corresponding addition is made to equity capital.

Q. That is at the top of the lower half under the



heading "Liabilities"?

A. Yes, Adjustment (a) is shown against the Government of Canada Loans again in red ink figures, and in black ink figures up against the capital stock of the Canadian National Railway <sup>Company</sup> /, meaning that one account is reduced and the other account is increased. Adjustment (b) is recording the Government's obligation to furnish an additional \$300 million in the form of equity capital. On the lower half of the statement it is shown as addition to equity capital, and on the upper half of the statement it is set up as a capital fund receivable from the Government of Canada. Adjustment (c) evidences the exchange of capital stock of the Canadian National securities trust, \$378,518,135, for an equal amount of Railway Company capital stock. In the lower half of the statement it will be noted that the capital stock of the securities trust disappears and a corresponding increase is made in the capital stock of the Railway Company.

Q. And that is the black figure?

A. Yes.

Q. For a like amount?

A. Yes, the capital stock of the Canadian National Railway Company, which is now \$18 million, would then become \$1,457,012,960.

Q. Is there any other comment that you would care to make concerning the statement, Mr. Cooper?

A. No, but I would be glad to answer any questions.

Q. Now, by way of further evidencing the effect of the suggested changes, I asked you to be good enough to prepare, or to apply these proposed changes to the net





income results for the year 1949. You have prepared such a tabulation, haven't you?

A. Yes.

Q. I would ask you to produce that as Exhibit 246, which is entitled "Canadian National Railways Net Income Results, Year 1949".

... <u>EXHIBIT 246</u> ...	filed by	:	Canadian National
	Mr. O'Donnell	:	Railways Net Income
		:	Results, Year 1949.

Q. Would you be good enough, Mr. Cooper, to make such comment and explanation as you think this Exhibit requires.

A. The first figure shows our net income deficit as published for the year 1949, \$42,043,000. I may add here that these figures have been rounded off into even thousands. Then I have shown the various adjustments that should be made to disclose the results which we would have had in 1949 if the various freight rate increases which have been authorized had been in effect for the full year, and if the proposals in the President's submission to the Commission had been approved and made effective.

The first adjustment is \$12,056,000. That represents the additional revenue which we would have received if the 8% freight rate increase had been in effect for the full year. It was in effect only from October 11, and of course from that date to the end of the year the \$42 million figure includes the benefit of that increase; but had it been in effect from the beginning of the year, our revenue would have been improved to the



extent of \$12,056,000.

The next figure shows the additional revenues if other rate increases which have been authorized also had been in effect for the full year. There was an increase in passenger fares and in telephone rates; there was an increase in freight rates in the United States and also something, I think, for passenger.

COMMISSIONER INNIS: That is purely an estimate on your part?

A. Oh, yes, then I have shown the additional revenue which we might have expected to receive on the assumption that the 8% had been 16%, and that that had been in effect also for the full year. On those assumptions our additional revenues in 1949 would have been \$32,943,000.

Then I have shown in reverse the elimination of a special credit from deferred maintenance reserve of \$8 million. That was a credit which we had in 1949. It is a non-recurring item. The deferred maintenance reserve will be exhausted at the end of this year, so we cannot depend on further aid from that source.

Those adjustments altogether draw down to a net of \$24,943,000, and on those assumptions the deficit of \$42,043,000 would have been reduced to \$17,100,000.

Then, if interest on Government loans were cancelled, there would be a credit or a relief to the extent of \$21,798,000. If we take credit also for the 3% on the \$300 million, the results would be further improved by \$9 million. On those assumptions, instead of a deficit in 1942 of \$42 million, we would have had a surplus of \$13,698,000.





Q. That is 1949, not 1942 there?

A. 1949. I wish to mention that in these assumptions or estimates we have not made any provision for possible wage increases which might result from negotiations which are now in progress, nor have we made any provisions for further increases in the price of materials. I wish to point out that the surplus of \$13,698,000, that is, the indicated surplus, is equal to a return of only  $3/4$  of 1% on the proposed equity capital amounting to \$1,834,737,474.

COMMISSIONER ANGUS: Could not the special credit from deferred maintenance reserve pay for unusual maintenance in that year?

A. Well, that is a difficult question. Whether the maintenance in the year 1949 was normal or excessive is a very difficult matter to determine. Talking to our engineers, they take the position that we did not overspend on maintenance account in 1949. When we set up our deferred maintenance reserve during the war, the understanding was that it would be used up in five years after the war, and that is the program that we are carrying out irrespective of the actual maintenance which has been performed.

Q. You don't think it is a fair expectation that if the credit from the deferred maintenance reserve were eliminated, the maintenance cost would go down by the same amount?

A. I don't think so. I think we still have a backlog of deferred maintenance to catch up.

THE CHAIRMAN: Pardon me a moment, what were those last two figures? If interest on Government loans

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were cancelled, \$21,798,000, interest on Government indebtedness \$9 million. How do you arrive at that result of \$13,698,000? There must be some factor there I don't see.

A. The \$17 million up above is a deficit. The 21 - -

Q. You mean \$17,100,000?

MR. O'DONNELL: It is said to be a deficit adjusted as above, that is, a deficit figure.

THE CHAIRMAN: Yes, well, what figures together bring out \$13,698,000?

MR. O'DONNELL: Will you explain that, Mr. Cooper? That one figure is a deficit figure, and it is a matter of deducting that <sup>from</sup> the addition of the other two. That is correct, isn't it?

THE CHAIRMAN: If you add \$21,798,000 to \$9 million, and from that sum you subtract \$17,100,000, is that it?

A. Yes, sir.

(Page 18661 follows)





MR O'DONNELL: And that gives you the net income as adjusted, surplus, \$13,698,000.

Then I would turn to another subject, my lord, if there are no other questions of Mr. Cooper, and would go to page 80 of the brief, Exhibit 214, Chapter IV, "Uniform Accounting and Other Related Matters." The submissions of the Canadian National Railways in that connection will be found beginning at page 80 and continuing to page 152.

I think at this point I might produce as Exhibit 247 the Exhibit "B" referred to in the brief at page 87, it being entitled "Proposed Uniform System of Accounts for Steam Railways." It contains certain suggestions concerning modifications of the Interstate Commerce accounting classifications.

THE CHAIRMAN: Exhibit 247 is the one that you refer to on page 87 as Exhibit "B"?

MR O'DONNELL: That is right, sir. "B" with the formal brief now becomes Exhibit 247.

---EXHIBIT 247: Exhibit "B" to C.N.R. brief -  
Proposed Uniform System of Accounts  
for Steam Railways.

MR O'DONNELL: Then Exhibit 248 is the document which was produced with the brief as Exhibit "C", which is referred to at page 92. It is entitled "Interstate Commerce Commission, Bureau of Statistics, System Consolidated Reports for Steam Railways - Discussion of Tentative General Principles." I would indicate that on the face of the report itself it says, "This report has not been considered by the Commission, and is released for criticism and suggestion only." It is dated July 1, 1937.

---EXHIBIT 248: Exhibit "C" to C.N.R. brief -  
Interstate Commerce Commission,  
Bureau of Statistics, System Con-  
solidated Reports for Steam Rail-  
ways - Discussion of Tentative  
General Principles. Dated July 1,  
1937.



MR O'DONNELL: I might just draw to the attention of the Commission that on the third sheet of Exhibit 247 there is a summary of what the contents of Exhibit 247 deal with. They deal with accounting, classifications governing investment in road and equipment, operating revenues and operating expenses, income, profit and loss, general balance sheet accounts, train miles, locomotive miles and car miles; and it is suggested that they might be prescribed by the Board of Transport Commissioners for Canada if and when the matter be reviewed. I understand from Mr. Cooper that this is put forward as tentative proposals for consideration and discussion.

Q. Would you tell the Commission, Mr. Cooper, why this document was prepared in the detailed way in which it has been?

A. We wish to be of assistance to the Commission, to show them the sort of thing that we have in mind in recommending uniform classification. Someone has to do the spade work on things of this kind, and that is about all we have tried to do. I do not imagine or suggest that this is the classification that will be adopted, but I think it will be of assistance to those who have to develop the classification itself to have a draft, as it were, on which they could make their changes as they may decide. It is suggested only in the effort to be of assistance, and we do not imagine that it will be adopted as is.

MR O'DONNELL: Now, my lord, as I said, the submissions of the Canadian National concerning uniform accounting and other related matters are in the brief between pages 80 and 152. It occurs to me that it would save a lot of time if I assumed, as I am sure is the fact, that the Commission and the interested parties have read those pages, and, rather than go over the matter with Mr. Cooper at this





time, I might, acting on that assumption, just allow Mr. Cooper to proceed to be cross-examined on the matter, subject to my saying at the end, in the event that there is anything to be added, that I would like to ask a few more questions. I think it might save a lot of time, rather than going over it, because I have noticed that what happens is, you cover it in chief, and then everybody else covers it again. So, with that understanding, that if there be anything at the end I might have the right to ask further questions, I will say that I have no further questions from Mr. Cooper at this time.

EXAMINED BY MR COVERT:

Q. I take it, Mr. Cooper, that our discussions will relate to three things -- the revision of the capital structure, the treatment of surplus earnings and uniform accounting; those are the three subjects that you are prepared to deal with. You have prepared and filed this morning what might be termed a pro forma consolidated balance sheet giving effect to the proposals as outlined in the brief?

A. Yes.

Q. That is Exhibit 245.

A. Yes.

Q. Now, are the 1949 figures available yet?

A. Well, we have them, but it is customary before releasing our balance sheet and report that it shall be tabled in the House of Commons. We expect that will be done this week, and I would prefer not to---

MR COVERT: Well, from our point of view there would be no substantial difference. My only point, Mr. Chairman, was that perhaps they could file that with us, because if it were a matter that---



MR O'DONNELL: We will be glad to do that just as soon as it is released. Mr. Cooper says the custom is that it is filed in the House first, and just as soon as it is released we will have it up here.

MR COVERT: Q. I just wanted to have a short look at that with you. As I see the picture, the only change in the assets side, that is, as it exists at the end of 1948, in the proposal, is the addition of this \$300 million Government of Canada capital funds receivable; that is an accounts receivable that you have set up based on I think it was item 2 of Mr. Gordon's proposals?

A. That is correct.

Q. And on the liabilities side, in effect what you have done is to take the capital stock item in the securities trust and the Government of Canada loans and you have changed those to capital stock?

A. Yes.

Q. And then you have assumed that this \$300 million which was the second item in Mr. Gordon's submission is also capital stock, so those three items have changed your capital stock from \$18 million to \$1,457 million odd?

A. That is correct.

Q. And that simply erases from the liabilities side of the balance sheet the capital stock in the securities trust?

A. Yes.

Q. And then it takes out the Government of Canada loans of \$760 million?

A. That is correct.

Q. The same thing exactly would appear in the 1949, except that the other figures would be changed?

A. Yes. The Government loan figure of \$760 million plus will be somewhat different at the end of 1949 than it was at the end of 1948 -- not a substantial difference. The





\$378 million of securities trust will remain unchanged from what it was at the end of 1948.

Q. I also thought, Mr. Cooper, that it might be advantageous for the Commission to have you take Exhibit 217, which is your 1948 financial statement, and turn to page 4. It occurred to me that it might be useful for the Commission to have filed as exhibits the consolidated income account for the years say 1939 to 1948, with just the following items -- total operating revenues, total operating expenses -- and that would give you your net operating revenue; then the net railway operating income and your total other income. Now, on that point I just wanted to make sure -- perhaps I am wrong in asking you for that; I am considering it from the point of view of what the effect of it would be, bearing in mind the proposals made in the brief had they been in effect say in 1939.

(Page 18668 follows)



Then you would make these adjustments. I am thinking of it from the point of view of your position if you were appearing before the Board of Transport Commissioners with figures of this kind for, we will say, that period from 1939 on. I just wanted to ask you at this stage whether you thought under those circumstances that Other Income should be included, or would you omit that from the --

A. I am not quite sure why you think it should be excluded.

Q. Well, I was asking you, Mr. Cooper, to include it, and then I wanted to know if in your view it should be included. If it should why that suits me.

A. I understand, Mr. Covert, that you would like to see an income statement for each year, 1939 to 1948 --

Q. Yes.

A. -- showing what the net result would have been if the government interest had been cancelled --

Q. Yes.

A. -- and if this arrangement with respect to the \$300,000,000 had also been in effect.

Q. Yes. I think perhaps by looking at your Exhibit 228 we can pretty well get the picture, but I thought that might be prepared with just those items. Then the next item I would ask you for is the total deductions from income and then the figure net income available for payment of interest?

A. Yes.

Q. Then you would have your interest on the funded debt as revised?

A. Funded debt public would not be changed.

Q. Pardon?

A. Interest on the funded debt due to the public would not be changed. It is only the interest on the government loans





that would be changed.

Q. What I was trying to arrive at was this, Mr. Cooper. My understanding is that you have felt that this capital revision is very important to the Canadian National, that it should have taken place long ago, and now you are putting it forward and saying it certainly should take place now. What I want to see is what the effect would have been had this been put into effect say in 1939.

A. Yes. I put it to you though that you are asking me to take the war years, or what I would call the war and post-war period, and that probably on that picture you would get a rather optimistic picture of the Canadian National.

Q. I agree with that but I thought we should have that information. I am going to discuss the long term with you later. I think I can do that best on your Exhibit 228, but I would like that. It is a comparatively easy job?

A. Yes.

Q. Then you see I would like to have --

THE CHAIRMAN: Pardon me. This information to which you have just referred will be put in the shape of an exhibit?

MR. COVERT: Yes, Mr. Chairman.

THE CHAIRMAN: All right.

MR. COVERT: Q. Then you see you would show the interest on the funded debt as revised, assuming that your interest charges were less the amount that this proposal of yours would bring about.

A. Yes, I think I understand what you want but --

Q. And that would show --

MR. O'DONNELL: Let him finish.

THE WITNESS: I think I understand what you want but before we go to work on it we will check with you and see that we understand very clearly what it is you want, and I can assure you that you shall get what you want.



MR. COVERT: Q. Then I think you may as well bring down one further line and show the surplus or deficit each year.

A. Yes.

Q. Now, have you a copy of Exhibit 228 before you? That is the one dealing with the result of operations 1923 to 1949.

A. Yes.

Q. If you would take the fifth column -- that is counting the years as a column -- that shows income available for fixed charges. What I wanted to know was this. If, for example, that had been in effect, we will say, for the first period, that is, 1923 to 1931, you would have to add to that \$9,000,000 each year on that \$300,000,000. That is \$300,000,000 at 3%. That is if the present proposal was in effect for that period.

A. Yes, but I would question whether that was going to give you a correct picture. The \$300,000,000 contemplates conditions as they exist today which are very different indeed from what they were in 1923. Part of the justification for the \$300,000,000 lies in the changes which have taken place, especially in the last four or five years.

Q. In other words, you say that the reasons for the government acknowledging this indebtedness of \$300,000,000 to the C.N.R. which exist today did not exist in the period 1923 to 1931?

A. For example, take the Newfoundland Railway --

Q. Could we just start off with yes or no to that, Mr. Cooper?

A. Would you repeat your question?

Q. I say what you say is that the reasons that exist today for the government acknowledging this indebtedness of \$300,000,000 to the C.N.R., which is set out in the proposal,





did not exist in the period 1923 to 1931?

A. Yes, I say that.

Q. Well, I think I follow you there, Mr. Cooper, but if these proposals had been in effect what you are saying is I am being unrealistic in doing that?

A. I do.

Q. But if they had been in effect what you would have to do would be to add \$9,000,000 a year to each one of these years?

A. Deduct it, I think.

Q. To the income available for fixed charges?

A. Oh, I beg your pardon, yes, to the income available for fixed charges, yes, or reduce the next column by \$9,000,000.

Q. So that that would mean that the average instead of \$28,000,000 would be \$37,047,056?'

A. That is in the first nine years, is it?

Q. Yes?

A. Yes.

Q. Similarly in the next period, 1932 to 1939, you would add \$9,000,000 which would make the income available for fixed charges \$59.4 million roughly?

A. But I think you are --

Q. Cannot --

MR. O'DONNELL: Let him make his comment.

THE WITNESS: I do think you are forcing a very unrealistic set of figures.

MR. COVERT: Q. Let us assume, Mr. Cooper, that you are right, that it is very unrealistic. You say the conditions which apply in 1950 did not apply in 1932 to 1939?

A. Very definitely.

Q. Now then, coming to 1940 to 1949, where the average is \$49.25 million, again that would bring that to \$51.2 million



if the \$9,000,000 is added?

A. 51.2?

Q. 58, I am sorry.

A. 58, yes.

Q. Would you say that it would be improper to apply those considerations for that period as well?

A. Yes, sir.

Q. So that you say the application of this \$300,000,000 indebtedness only became necessary as of now?

A. No, I do not say that. I say that the situation as it exists today, with the legacies of the past and looking into the future, requires this adjustment.

Q. Requires it today. When would you think that properly should have been done? Do you say it is just now?

A. Well, as far as the interest on the \$804,000,000 is concerned, which was approximately \$35,000,000, it is my opinion that should have been done in 1923.

Q. I am just talking about the \$300,000,000 adjustment now.

A. That is a remedy to a condition which now exists and the situation is changing. The situation today is different from what it was a year ago. I have mentioned Newfoundland. You have got the Temiscouata Railway, and looking into the future with respect to all the things which may be done I do not think you can go back to a date such as the year 1943 or 1945 and say from that date this adjustment which is being proposed as of today would have been the adjustment to have been made at that time.

Q. In other words, you say as far as any adjustment of that \$300,000,000 figure you cannot properly take it back of 1949?

A. I say it should be applied to the conditions as they exist today.



Q. But you say it cannot be taken back of 1949? Can we have yes or no to that?

A. For 1949 itself?

Q. Yes?

A. Yes, I think it might.

Q. But you would not take it back of 1949?

A. On the assumption that the Newfoundland Railway was going in as of January 1, 1949, which of course it didn't do.

Q. But you would not take it back of 1949 then?

A. No, I do not think I would.

Q. Mr. Cooper, I did not quite get the three reasons that you gave this morning. I wonder if you could repeat those to me now?

A. Reason 1: Capital requirements of the Canadian National in the next five years will amount to \$307,869,711.

Q. That is future capital requirements?

A. Yes.

Q. How many years?

A. Five years.

(Page 18675 follows)





(2) Those maturing obligations, including equipment serial payments in the ten-year period 1950-1959 total \$377,333,053.

Q. So roughly that is to meet maturing obligations of \$377 million over the next ten years?

A. Yes.

(3) The relief of Government interest plus the \$9 million would be \$30,798,000.

Q. Now, would you explain that to me?

A. Well, the Government interest in 1949 was \$21,798,000.

Q. Yes.

A. If you increased that by \$9 million, then the relief is \$30,798,000.

Q. Yes.

A. And that is the relief which these proposals, if adopted, would give to the Railway. Now, I then go on to show that based on the record of the past adjusted to present day conditions with respect to depreciation and the Newfoundland Railway, that the deficit from 1923 to 1949 would have averaged \$29,977,989, or within less than a million dollars of the relief itself. And of course I have not brought in everything that I could have brought in to build the deficit up. I could have added the Temiscouata Railway for example. I am sure the Newfoundland Railway will exceed \$4 million.

Q. Mr. Cooper, just looking at Exhibit 228, it seemed to me there that your average deficit for the period was \$20,808,000?

A. That is correct.

Q. That is after payment of all fixed charges?

A. Yes.

Government owned and operated.

1930-1939 total \$37,813,000.

The majority of it is to meet maturing obligations.

It is not until the next two years.

At that time.

(1) List of Government owned and operated.

also the \$2 million would be \$2,000,000.

It would explain that to you.

At that time the Government interest is \$1,000,000.

\$2,000,000.

At that time.

It is not announced that by \$2 million then.

It is \$2,000,000.

At that time.

It is not that is the reason which \$2 million.

It is not that is the reason which \$2 million.

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It is not that is the reason which \$2 million.

Q. Now, I am sorry, but I missed how you tied that in to bring it down to the thirty.

A. Starting with that figure - -

Q. Yes.

A. I then assumed that depreciation accounting on rolling stock in Canada had been in effect from January 1, 1923.

Q. I see.

A. And that increased the \$20,808,914 to \$25,977,989. Then to that I added \$4 million for Newfoundland.

Q. Yes.

A. So that I say, adjusting the record of the Company since amalgamation to present day conditions with respect to depreciation and Newfoundland, our average deficit has been \$29,977,989; so that the relief, if given, would, on the record as adjusted - -

Q. Be less than a million?

A. Just about make the break-even point.

Q. And I just want to ask you about this. Do you think that does present a true picture in dealing with it in that way, by taking your average deficit over the 23 years and adding to that about \$5 million you said, I think - was it?

A. Yes, just over \$5 million.

Q. Just over \$5 million for depreciation?

A. Yes.

Q. And you think that brings comparable figures together, the proper figures together to put it on the basis of present day methods?

A. Well, those are two major adjustments which





obviously should be made. I did not go beyond that.

Q. I see. Then, Mr. Cooper, could we just examine Exhibit 228 from this point of view. Let us assume that you had not the \$300 million acknowledgment of indebtedness, but had this capital revision in 1923, that is, the reduction of the funded debt as proposed in the submission. If you had had that in 1923, that would reduce your fixed charges by how much a year, approximately \$21 million?

A. In 1923 there were \$35 million.

Q. No, I am thinking of your interest on the funded debt which you now say should be wiped out.

A. Yes, \$21,798,000.

Q. \$21,798,000 or approximately \$21.8 million?

A. Yes.

Q. Then, as I say, had that been in effect in 1923, your income available for fixed charges during that first period from 1923-1931 was \$28 million about? That is the average for 1923-1931?

A. Yes, 28.

Q. So that that would have left you with a surplus of approximately \$6.2 million a year average?

A. The surplus would have been 3.9. The average deficit in that period was 17.9 million.

Q. No, I cannot arrive at that.

A. Well, do you mind looking over in the last column?

Q. Yes, I see that, Mr. Cooper.

A. Yes, that is our deficit.

Q. Yes.

A. If we had had relief of 21.8, why then we would



have had a surplus in that period of 3.9 million per annum on the average.

Q. I haven't any doubt that you are right, but can you tell me where I go wrong when I do it this way?

A. All right.

Q. Taking the 28 million average of income available for fixed charges.

A. Yes.

Q. I think I see it myself. In other words I have deducted the 21.8 when I should have deducted - -

A. You should have deducted the 21.8 from the 45.9.

Q. Yes, I see, I follow you now. In other words, to arrive at what would have been available for fixed charges, I deduct - -

A. I don't think you should touch that picture. I think you should reduce the fixed charges. The proposal is that 21.8 million of fixed charges should be cancelled, so that the 45.9 would be reduced by 21.8.

Q. Right, I follow you. You take the 45.9 in the second column over from the right, deduct from that 21.8, which leaves 24.1?

A. Yes.

Q. So that the average surplus in those years would have been 3.9 million, is that right?

A. Yes.

Q. All right. We then go to the next period, 1932-1939. In that case I would deduct from 55.7 the 21.8?

A. Yes.

Q. And that would leave me with 33.9?



A. 33.9, against which - -

Q. You only had - -

A. We had 6.3 million.

Q. So you would in those years have a deficit of 27.6 million a year average, is that correct?

A. Correct.

Q. And for the next period, 1940-1949, that is, just by looking at it, it looks as if you would have an average surplus of about 21.4 million, is that correct?

A. 22.3.

Q. 22.3 is it?

A. Excuse me.

Q. Yes.

A. No, it is 21.3, isn't it. 488,000 is a deficit. That would be improved by 21.8, so it would become 21.3.

Q. Now, if these proposals (I am not considering the \$300 million indebtedness now) if this funded debt had been altered in 1939 and you had carried on from then on with just the funded debt reduced - -

MR. O'DONNELL: Would you put that again, Mr. Covert?

MR. COVERT: If the revision of the funded debt had taken place in 1939 (I am omitting altogether the question of the 300 million indebtedness) then by 1946, Mr. Cooper, could you tell me what the position of your surplus would have been, that is roughly? That can be calculated quite quickly.

A. Back in 1940 - 1945? Do you include 1946?

Q. Yes.

A. We would have had an average surplus of 38 million.





Q. An average surplus of 38 million?

A. That is in the six what you might call war years.

Q. That is right. 1940-1946.

A. Yes, and my top figure here is across the line. I will have to do that again.

Q. I am sorry.

A. 34.1, if my arithmetic is correct.

Q. Well, I just want to get it roughly.

A. Right.

Q. Well, I must be pretty good or we are both that, because that works out that you would have a surplus over the seven year period of about 238.7 million, and I have just roughly done it and get 238 million. Would that be right?

A. How much did you say over - -

Q. 238 million.

A. Oh, no. Are you speaking of cash deficit? I make it 112 million in the seven year period.

Q. Now, let me see. Perhaps you can help me again with some arithmetic. What I thought, Mr. Cooper, was that we could take your fixed charges in those seven years, 1940-1946 and reduce those by 21.4 million a year.

A. 21.8.

Q. 21.8 million a year.

A. Yes. Well, the quicker way, Mr. Covert, I think, is to take the end figure, add them up, divide by seven and deduct 21.8 or add it as the case may be.

Q. Yes, then you get 34.1 you said?

A. Yes, I did.



Q. Per year?

A. My red figures came to 25.8, the black figures came to 112.3. The net was 86.7. I divide that by 7, which is 12.3. I increased that by 21.8 and arrive at 34.1.

Q. Then if you multiply that by 7.

A. Yes.

Q. That gives you 238.7. Wouldn't that be the - -

A. The aggregate.

Q. Yes.

A. Yes, I thought you were speaking of averages.

Q. Oh, no.

A. I beg your pardon?

Q. I am sorry. Then your aggregate surplus would be about 238 million?

A. In the seven years of war?

Q. Yes.

A. Yes. Could I interject something?

Q. Yes.

A. I don't know whether it is proper for the witness.

Q. Sure.

A. But taking the whole period this statement shows that our average deficit was 20.8, and the relief that we have been discussing was 21.8, so that if that relief had been effective throughout the whole period we would have had an average annual surplus of one million dollars a year. That seems to me to be what you would find looking back over the years, has happened to these Canadian National Railways of ours.





HH

---Upon resuming.

MR. COVERT: Q. Now, Mr. Cooper, I have handed you Volume 98. I propose to ask you about the surplus earnings which were dealt with by Mr. Gordon at pages 18388 and 18389 of the transcript. You will find that in Mr. Gordon's submission at page 16.

Now, Mr. Gordon said:

"Prudent business management and judgment have always approved the establishment of reserves in years of financial prosperity for use in the leaner years. On the assumption that our proposals are implemented, it is not unreasonable, as I have indicated, to anticipate that Canadian National will in some years have surplus earnings. The task of management would be greatly eased in my opinion, also concurred in by the board of directors, if there were a recommendation from your Commission that the board of Canadian National use such surplus earnings (a) to provide sufficient funds to cover expenditures for non-revenue producing improvements and betterments; and (b) to establish a rate stabilization fund which it is hoped could be built up in good years and drawn upon in poor years with the view of affording stability to the rate structure and tending, to the extent of the fund from time to time existing, to postpone the necessity of applications for general freight rate increases. Your Commission is respectfully invited to recommend the proposals which I have just made regarding this subject."

Now, first, I just want to ask you if that really involved giving to the Canadian National something similar to what the Board dealt with in the rate



hearings, that is, something to come and go on?

A. This section of the President's statement is one which will be dealt with by Mr. Fairweather.

THE CHAIRMAN: Q. By whom?

A. By Mr. Fairweather.

MR. COVERT: Q. But I might have some questions. Could you just tell me as to what --

A. As to what?

Q. As to whether or not this proposal involved there is really something similar to what the Canadian Pacific calls "something to come and go on"?

A. I would sooner not discuss it at all.

Q. I see. And do you not want to discuss either the question of providing sufficient funds to cover expenditures for non-revenue producing improvements and betterments?

A. Again, I prefer to leave it to Mr. Fairweather.

Q. I see. Well, would Mr. Fairweather also be able to show, in the accounts of the Canadian National, Mr. Cooper, something that would be similar over, let us say, a period of the last ten years, to item (a) in the paragraph which says "to provide sufficient funds to cover expenditures for non-revenue producing improvements and betterments;"?

A. I really do not know what evidence Mr. Fairweather has to produce.

Q. I see. My only point is that I would like that information from someone. You think he can give it, Mr. O'Donnell?

MR. O'DONNELL: I hope so.

MR. COVERT: Q. Perhaps I had better state here, so that Mr. Fairweather will know in advance and the information can be obtained, that what I want to find out is: What would be required to cover expenditures for non-revenue producing improvements and betterments, let



us say, based on the years 1939 to 1949?

And then I might put on the record now that I want to know whether or not that fund will be earmarked in any way as between the two items.

Well then, Mr. Cooper, we will leave that, and I want to discuss with you some parts of Mr. Gordon's statement. Will you take Volume 98 and turn to page 18373, please?

THE CHAIRMAN: What page of the document is it?

MR. COVERT: I will find out in just a minute, my lord. It is at the top of page 4 of Mr. Gordon's statement.

There he refers to:

"A realistic capitalization of the Canadian National must of necessity be related to its future earning power."

What I want to find out is how you would suggest calculating that future earning power?

A. I think the intent of that statement was to emphasize that a realistic capitalization of the Canadian National should not be built on the historical record of the past.

Q. You in effect ask us to relate it to the future earning power and I just want to know how you would arrive at it, or how that future earning power should be arrived at? Is there some method of calculating it?

A. I have not given that any study. The earnings of the Canadian National in the future will be related to the business activity of the country as a whole.

Q. Yes?

A. And if we know the trend of business activity for a period of years, I think we could reasonably forecast the gross earnings of the railway.





Q. That is what I had in mind. You would forecast it by looking at the past, and I wondered if you had made any calculation as to what you would regard as possible future earning power?

A. I have not done that.

Q. That sort of makes it impossible to create a realistic capitalization and relate it to it?

A. Yes, it is difficult even to estimate our results for the year 1950.

Q. Yes?

A. We do not know, for example, what wage increases may emerge from the present negotiations.

Q. Now then, on the same page and in the second paragraph Mr. Gordon referred to discernible trends which will be adverse to net earnings. And I want to point out to you that the Canadian Pacific, in its brief, seems to lay considerable emphasis on the growth and population of the country, and the trend of that growth, and the thought that it will provide greater traffic, a greater volume of traffic.

I think they calculate what each person who comes to this country really contributes to the traffic of the railway.

Has the Canadian National made a similar calculation?

A. I wish to refer to the evidence which I gave at the beginning of my examination. It appears on page 18464 where I said:

"A. Yes, Mr. Fairweather and I have co-operated on that part of the submission which leads up to the recommendations made by the President. Mr. Fairweather and I have many times worked together on problems which are both financial and economic. . . . Generally I furnish the factual



accounting information together with my views as an executive officer of the railway and Mr. Fairweather testifies as to the physical characteristics of the railway, its operations, and the economic significance of the facts developed."

Now, this paragraph, I submit, comes squarely under the phase of this submission that is to be dealt with by Mr. Fairweather.

I am not attempting to evade any cross-examination.

Q. Oh, no, no; I would not suggest that for a minute. If I ask you a question, you just tell me if Mr. Fairweather will answer it. But I thought perhaps the matter had been discussed and that you had taken into calculation any estimates. But you say he will deal with it.

A. I just call your attention to the fact that my evidence is really related to accounting, to factual accounting data, and on that subject I am fair game for any question you might like to shoot at me.

MR. O'DONNELL: I think Mr. Fairweather can answer it.

MR. COVERT: Yes.

MR. COVERT: Q. Well then, would the same also apply at the top of page 5 of Mr. Gordon's statement where he deals with future operations, where he says:

"Future operations will be burdened to some extent by the deferred maintenance of property and the deferred renewal of equipment resulting from war services of the system."

Then he goes on to discuss the question of inflation:

"While, during the period of high earnings,





reserves were set up to meet such expense, they have been seriously depleted by post-war inflation."

Will Mr. Fairweather deal with that too? And also with this question of inflation:

"Inflation bears with particular severity on the Canadian National by reason of its relatively low-traffic density."

A. Yes.

MR. O'DONNELL: Mr. Fairweather will deal with that.

MR. COVERT: Yes.

MR. COVERT: Q. And the question of pricing themselves out of the market, that will be for Mr. Fairweather; and at the bottom of page 5 and the top of page 6, referring to the construction of additional branch lines to develop the natural resources of the country, Mr. Gordon suggested:

". . . they are not likely for many years to produce sufficient railway earnings to pay the additional expenses which they entail and the interest and depreciation on their capital cost."

A. That is absolutely up Mr. Fairweather's alley.

Q. Now, on page 18379, and on page 6 of Mr. Gordon's statement, he refers to the characteristics of the line and he says:

"It is conceivable that in some years the property would do no better than meet its operating expenses. In good times it would be reasonable to expect fairly substantial earnings. For a property having these characteristics, it would be logical to consider that all of the capital should be in the form of equity and that none of it should be interest-bearing."



And the question I want to ask is whether or not in this case it might not be better to take the form of income bonds?

A. Dr. Clark , the Deputy Minister of Finance, told me once that he thought that income bonds were the lowest types of security. I do not know that I agree with him. I do not believe there is any marked advantage one way or the other.

Personally I had always thought of these adjustments in terms of income bonds, certainly so far as it was related to the repatriated securities.

But that is not the view of the President or of our directors. And they have recommended shares of common stock. I think it would be quite improper on my part to suggest something different from what my President has suggested.

COMMISSIONER INNIS: Q. I presume that is the position of your board of directors as well, because, after all, your President has only been in that office for a comparatively short time?

A. Yes. And he distinctly says that the proposal submitted to you has the approval of his board of directors.

COMMISSIONER INNIS: Concurrence means concurrence.

MR. O'DONNELL: That appears at the bottom of page 15.

MR. COVERT: Q. Now, on page 18379, and again at the bottom of page 6 of Mr. Gordon's statement, he said:

"After careful study I have come to the conclusion that to show results of operation which would meet commercial tests, the amount of interest-



bearing capital which may be included in a restatement of the capital structure should be of relatively small proportions, in contrast to the present interest-bearing capitalization of \$1,344,000,000."

Now I just want to know, Mr. Cooper, what you think "commercial tests" are, and what the application of that would be?

A. I think a commercial test would be the ability to carry the charge.

Q. The ability of the railway to service the interest charges on the funded debt?

A. Yes.

Q. That is your interpretation of the words "commercial test" there? Is that correct?

A. Well, a commercial test might go further than merely meeting the interest on the fixed charge debt. It would naturally expect that there would be some return on the equity capital.

Q. I wondered if you thought, for example, there should be a relationship between the funded debt and the equity capital? Is that one of the commercial tests?

A. Yes, that is one of the usual tests.

Q. And I gather you think that should be applied in this case?

A. Not entirely on a strict commercial basis, because of the reasons which have been pointed out, that the Canadian National Railways is expected to do many things which a commercial enterprise as such would not be expected to do.

I believe myself the problem of the Canadian National Railways cannot be compared precisely with that of another railway or that of any organization.

I think one has to consider all the factors





that are in the situation, and that is what has been done; and out of that consideration these proposals have emerged, and they represent the best judgment of the President.

Q. Yes. Well now, let me make my position clear. The proposals have been advanced to the Commission?

A. Yes.

Q. And I conceive it my duty to test them and make sure that they are fully understood. And I just want to find out, when they show or come to a conclusion after careful study, that they should meet commercial tests, I just want to find out what that means.

I did want to find out, for example, if you felt there should be some relationship between equity capital and the funded debt, if that is one of the commercial tests?

A. I would say that if the rate structure would stand it, there should be a return on equity capital, but I would not think that the entire amount of capital is entitled to what might be called a commercial rate of return.

Q. No?

A. But the entire equity capital might be entitled to a small rate of return, yes; and I showed this morning that --

Q. It came to about three-quarters of one per cent?

A. That on recapitalization, that the net income for the year 1949 would be three-quarters of one per cent on the equity capital.

Q. That is right, and even including certain adjustments which you have made in that exhibit?

A. Yes. I have stated it in that as favourably as it is possible to state it.

After all, one should keep in mind that that



statement is based on gross earnings of \$533,000,000.

COMMISSIONER ANGUS: Q. Was not that three-quarters of one per cent calculated without allowing for the surplus which you say the railways should have?

A. The surplus of \$13,000,000?

Q. The three-quarters of one per cent?

A. Yes, sir.

Q. Can you say that you are making a return on your equity capital, and the surplus, if you are using the same sum --

A. I think the surplus is a return on equity capital.

Q. And is something to come and go on?

A. Something to come and go on, and it is a return on equity capital.

Q. You identify those two things?

A. I think everything, after the payment of fixed charges, is a return of equity capital. Whether you distribute it or put it back into the business is a matter of judgment.

Q. And when you say you think the Canadian National Railways should make a return on their equity capital, you do not mean after providing for a reasonable surplus?

MR. O'DONNELL: I think in the sense you were apparently using the word "surplus" there, I do not think that is the fact.

In the Board of Transport Commissioners' judgment, a just and reasonable rate was fixed on the basis of

requirements, and requirements being operating expenses, interest requirements, a reasonable dividend <sup>a</sup> and reasonable surplus.

Now, that rate being fixed, the proceeds of that rate, in the case of the Canadian National, go to the Canadian National, and with those proceeds we include





the surplus to come and go on, or the additions and betterments amount, or whatever it is. It has been termed differently by different people. It includes that, and after having received that just and reasonable rate with this surplus allowance in it, then the item of surplus which Mr. Cooper speaks of is what remains after we have paid our operating expenses and interest charges.

I think the words are used in two different senses.

(Page 18698 follows)



MR COVEET: Q. What I wanted to find out, Mr. Cooper, first, was, do you think that there should be a similar relationship between equity capital and funded debt in the case of the C.N.R. as in other railways?

A. I think the factors in our situation justify the relationship in the case of equity capital being smaller than would be the ordinary ratio of equity capital to total capital.

Q. That is---

A. Did I say smaller?

Q. Yes.

A. I mean that our proportion should be higher.

MR O'DONNELL: Q. You should have more equity than fixed charge debt.

A. Yes.

MR COVERT: Q. Then in the case of a privately-owned railway?

A. I prefer to speak of the Canadian National Railway. I think there are factors in the Canadian National situation which justify a very high ratio of equity capital to total capital.

Q. I suppose that is one case where commercial tests do not apply?

A. They do not apply identically. I think that, using the word "commercial test" in a broad sense, we should get some sort of return on our equity capital in addition to paying our fixed charges. I do.

Q. The usual reasons for relationship between equity capital and funded debt do not apply in the case of the C.N.R. as they would in a privately-owned company, do they?

A. Well, you see, your comparison is so broad.

Q. I was under the impression that the reasons for having a proportion of the total capital in funded debt



were these: First, that the amount of the funded debt should not be as great as the value of the property -- in other words, there should be some leeway for security -- and, second, that the earnings, especially for funded debt, should certainly always be sufficient to service that debt?

A. Yes.

Q. And the reason for having a proportion of equity capital was that in times of depression you should have some of your capital upon which you may not have to pay a return?

A. That is so.

Q. Those considerations would not apply in the case of the Canadian National?

A. In fixing the amount of fixed charge debt for any enterprise there must be regard for the ability to service that debt. If you were to submit a recapitalization proposal to the Interstate Commerce Commission they would want to determine the amount of net earnings that would be available under all conditions. Having determined that amount, they would fix the amount of permissible fixed charge debt. Now, if that is fixed, only the balance, irrespective of the proportion, can take the form of equity capital. So the amount of equity capital is determined by the protection that net earnings afford to the fixed charge debt. It is not to be determined by some arbitrary proportion such as sixty and forty or anything of that sort. In our case we say that the ordinary relationship between the two should not be used.

Q. Then do I understand you, Mr. Cooper? You say that in the case of the Canadian National the ordinary relationship should not be used?

A. I do.

Q. And the reason for that is?





A. For example, in 1949 we earned \$4 million which was available for the payment of interest. Now, how much fixed charge debt would that justify? A very small amount.

Q. Well, you would not say, then, because of that, Mr. Cooper, would you, that you should only have a funded debt that would carry \$4 million of service charges?

A. We must take into account the ownership of the Canadian National, we must take into account that its funded debt is guaranteed by Canada, and you cannot alter that fact; it is there. Our funded debt position depends not so much on our ability to meet the interest as it does on the security of Canada behind our obligation.

Q. I think that is a very important point that should always be taken into consideration in dealing with the funded debt of the Canadian National. Wouldn't you agree?

A. Yes.

COMMISSIONER ANGUS: Q. From the standpoint of the publicly-owned railway I suppose having fixed charges at all is simply shall we say a regrettable accident; there is no purpose in having them, is there?

A. Well, yes, I think that there are advantages in having railway securities financed by public issues. Equipment trust notes, for example, is a method of financing the purchase of new equipment. It is very popular. The banking houses, investment houses, like to have those securities. I think, taking that as an example, that would be a good reason why, apart from all the other considerations, some proportion of our funded debt should be held by the public. But our present funded debt is very much the result of what came over in 1923. It has not been scaled down a great deal. In 1923 it was \$804 million, and at the present time I think it is \$574 million.



MR COVERT: Q. What I really wanted to come to was this, Mr. Cooper, that for instance in the case of a privately-owned railway the funded debt must not be so great that it would be impossible to raise equity capital, and that by and large through the good and bad years the income from operations will be such that the equity capital is likely to have a fair return?

A. You are speaking of the privately-owned railway?

Q. Yes.

A. Yes. Well, that is not my affair.

Q. No, but I am saying that that consideration would not apply with equal force to the Canadian National?

A. No, I do not think so.

Q. You may recall in your brief, Mr. Cooper, dealing with depreciation, you point out that it is a state-owned railway and it is in a class by itself, and this greatly minimizes the importance of depreciation accounting. You will recall that?

A. Yes, I do.

Q. And I suppose the same really applies to your capital structure?

A. I think the fact that we are a state-owned railway has a very definite bearing on the capital structure of the Canadian National. I think one thing, too, could be added there, that if it were not for the Government ownership of the Canadian National all the capital would be in the form of equity capital, because the earning record of the company would not justify any fixed charge debt.

Q. In other words, if the railways had gone through a reorganization, you say they would probably have had to use income bonds in a reorganization?

A. That might have been one way, yes.





Q. I thought, as a matter of fact, Mr. Cooper, that we were not far apart on that, because I think there was another place in the brief on depreciation; again I think you suggested that the value of the obligations of the C.N.R. depended on the guarantee by the Canadian Government?

A. Yes. I said yesterday that if it were not for the availability of Government credit we could never have carried on at all.

Q. You do not think, then, that as a result of that any relationship between your funded debt and equity capital is relatively unimportant?

A. I think the amount of the fixed charge debt should be related to the earning power of the railway.

Q. That is right. In other words, what I want to find out is, first, if you think there should be any relationship between that and the equity capital, or if the relationship really should be made to the earning power?

A. I think it should be made first to the earning power -- that would decide the amount of fixed charge debt -- and the balance should be equity.

Q. Now would you turn to page 18384 -- page 12, Mr. Chairman, of Mr. Gordon's statement. In the penultimate paragraph on page 12 you say:

"Consideration must also be given to the situation created recently through the entrustment to Canadian National of the Newfoundland Railway and Steamship Services and the Temiscouate Railway."

I wanted to ask you first if you knew why these two railways were entrusted to the C.N.R. System in this manner rather than treated as perhaps the Hudson's Bay Railway is. Now, if it is a matter of Government policy, and the C.N.R. has nothing to do with it, just let us know, but if there were any reasons---



A. It is essentially a matter of Government policy.

Q. I see. Now, my understanding is, Mr. Cooper, that the Hudson's Bay System is not brought into your accounts?

A. No, it is not in our accounts. We manage the railway, but the revenues and expenses are for account of Government and do not enter into our system figures at all.

Q. That, in your view, I take it, Mr. Cooper, is a preferable manner from the point of view of the Canadian National?

A. Far be it from me to criticize Government policy.

Q. Perhaps I should not have asked it. I just wanted to find out, for instance, a situation like that, at least the morale of the employees of the Canadian National is not affected by a situation such as exists on the Hudson's Bay Railway?

A. Well, expressing a personal opinion, I would say Hudson's Bay Railway should be in the National Railway System, provided that the arrangement between Government and the railway was an equitable one. I believe myself personally that all Government-owned railways in Canada should be in the Canadian National System.

Q. Does it lend to better operation?

A. We do operate the Hudson's Bay Railway.

Q. Well, I think the reasons that you suggest that might be very interesting to the Commission?

A. The reason why the Hudson's Bay Railway was not included in the system was that it has never been completed. For a long period of time it was always operated as under construction.

Q. Wasn't it in once and then taken out?

A. It was in in 1923 and it was taken out in 1926.

THE CHAIRMAN: Q. Well, is it still uncompleted



in that sense of the word? Is it still under construction?

A. Today, sir, I think it would be considered as having been completed, but for a long period of time, I would say certainly into the thirties, it was considered as under construction.

Q. Into the thirties?

A. Yes, sir.

Q. Then I suppose that now all information concerning that railway, its financing and so on, is to be obtained by us from the Department of Transport; is that so?

A. I think so, yes.

Q. Not from you?

A. No. We do keep the accounts, but we turn them over to the Department of Transport and they bring down a vote in the House, and we have nothing further to do with it. We are in the position of an agent or a manager, and we get a small fee for managing that railway.

MR COVERT: Q. On page 18385, which is page 13 of Mr. Gordon's statement, it states:

"Large amounts of capital have been spent upon development branch lines, the whole cost of which by necessity has been provided by the issue of interest-bearing obligations, whereas in sound financing procedure, a substantial percentage of the cost should have taken the form of equity financing. The amounts so expended total \$85,000,000, and if a minimum of 40% be taken as the amount which should represent equity capital, the capital burden of the Canadian National is in this respect excessive to the extent of \$34,000,000."

Now, I was not sure, but are you to furnish a list of those roads, Mr. O'Donnell?

MR O'DONNELL: I don't remember.





THE WITNESS: We promised to do that, Mr. O'Donnell.

MR COVERT: That is the one that has been promised.

COMMISSIONER INNIS: Q. What rate of interest would you have to pay for equity financing for branch lines?

A. I do not understand that question. What rate of interest would we have to pay for equity capital?

A. Yes.

A. There is no fixed charge on equity capital.

Q. I know there is no fixed charge, but what would you regard as attractive from the standpoint of the market?

A. In this proposal it is saying in effect that the Government should provide 40 per cent of the cost of building these development lines. That is to say, that it should be capital which would be free of a fixed interest charge.

Q. I am thinking of your sentence, "A substantial percentage of the cost should have taken the form of equity financing." You are still thinking of that as being within the Government; you are not thinking of floating it on the market?

A. I think that all the stock ownership of the Canadian National Railway System should be in the Canadian Government .

THE CHAIRMAN: Q. Tell me this: The word "development" there might or might not have the meaning that I am wondering about. Are all branch lines to be considered here as being included in this term "development branch lines"?

A. My lord, that is a matter that---

Q. Or are some of these branch lines developmental and others not so, just feeders, necessary feeders to the main lines?



A. The economic usefulness of those branch lines is a matter which Mr. Fairweather is prepared to discuss, and I think you would get better information from him.

Q. You speak of the amounts so expended, and so on, \$85 million; is the reference there made to all your branch lines or only to certain ones which you designate as being development branch lines?

A. Sir, it is the amount which has been spent on development lines since 1923.

Q. Not all your branch lines?

A. No, sir.

Q. And you say Mr. Fairweather can tell us all that---

A. He has a list of those branch lines, yes.

COMMISSIONER ANGUS: Q. Have these lines added to the general earning power of the system?

A. Yes.

THE CHAIRMAN: Q. Might one say this, that they are lines which the railway itself as a company would not have built?

A. I would not go as far as that, my lord.

Q. You would not go as far as that?

A. No, sir.

THE CHAIRMAN: Well, Mr. Fairweather perhaps will give us further information on that.

MR COVERT: Q. There was one point that struck me there in that same paragraph, Mr. Cooper. What is the present proportion of funded debt and equity capital in the Canadian National?

A. In 1948 it was 36.7 in the form of equity capital and 63.3 in the form of interest-bearing debt.

Q. That is pretty close to sixty-forty, and that is the same thing that you suggest in that paragraph; is that right?





A. We are not suggesting that 60 per cent of our total capital should be in the form of interest-bearing debt.

Q. No, no.

A. But this does say that in financing the construction of development lines at least 40 per cent of the funds should come to us from the Government free of interest. That is what that statement says.

Q. I just wanted to see how that compared with the present proportion between the two. Now, at page 18386, which is at the bottom of page 13 and page 14 of Mr. Gordon's statement---

THE CHAIRMAN: You are going to start a new subject?

MR COVERT: Yes, sir.

---The Commission adjourned at 1:00 p.m., to meet again at 2:45 p.m.



OTTAWA, ONTARIO  
MARCH 21, 1950.

A F T E R N O O N   S E S S I O N

T. H. COOPER - Recalled

EXAMINATION BY MR. F. M. COVERT, K.C., Cont'd.

THE CHAIRMAN: Very well, Mr. Covert.

MR. COVERT: Q. Now, Mr. Cooper, would you take Mr. Gordon's statement and look at the bottom of page 13, and continuing on to page 14, under the heading of "Summary", where he says:-

"SUMMARY

Summarizing the above, the following statement of excessive capital burden upon the Canadian National system is obtained:..."

And then he sets out those various amounts which total \$1,533,000,000.

I want to direct your attention first to the use of the words "excessive capital burden upon the Canadian National System". This would seem to indicate that on the basis of these calculations which I think you say are conservative, there is a capital burden in the Canadian National System which is excessive to the extent of \$1,533,000,000.

Now, according to the balance sheet of the Canadian National, I think your total capital is approximately \$2,118,000,000 odd, made up of funded debt in the public, \$584,000,000, Government of Canada loans, \$760,000,000, and proprietors' equity of \$774,000,000.

Now, if you have an excessive capital burden of \$1,533,000,000, your proper capital, after eliminating the excess, would be about \$585,000,000. Would that be right?

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[illegible]

A. The figures would be right, yes.

Q. Well now, does that mean that of your total capital, \$1,533,000,000 should not be funded debt?

THE CHAIRMAN: Will you please repeat?

MR. COVERT: Q. Does that mean that of your total capital, \$1,533,000,000 of that should not be funded debt, and that that would leave you a funded debt of about \$585,000,000, which is just about the amount in the hands of the public?

A. No, I do not think that is so.

Q. What I was trying to arrive at is the connection between this figure of \$1,533,000,000 and your total capital?

A. The figure of \$1,533,000,000 is more precisely termed capital debt burden, including the negative capital.

Q. Yes?

A. As has been said, it is really the capitalization of an annual deficit on the non-remunerative parts of the system. There is no suggestion there that the total capitalization of \$2,118,970,131.93 is too high.

I was at some pains to reduce that to a per mile of road, and I made a comparison with our costs per mile of road with the costs of roads and with the Canadian Pacific, and I proved, at least to my own satisfaction, that our costs were not excessive.

In our main statement we have declared that in our opinion there is no need to reduce the total capitalization; but what is needed is a more equitable division of the total capital as between the portion which carries the fixed charges and that which does not.

Q. What I was trying to do was to relate it to that phrase "the excessive capital burden upon the Canadian National System", which seems to be the





\$1,533,000,000.

A. I would be inclined to add the word "debt" after the word "capital" there.

Q. Capital debt burden?

A. Yes. That is, of course, in excess of our total debt burden, and the excess is brought about by introducing what has been termed "Negative Capital".

Q. What I was trying to do was to see if there was any connection between this figure of \$1,533,000,000 and the present recommendation?

A. Well, on the one hand, you have a ceiling.

Q. Yes.

A. If you like, of \$1,533,000,000, and on the other hand you have a floor, if you like, of \$760,000,000, which is the debt held by the public. It is in between those two figures that a meeting point had to be reached.

Q. I see; and the real purpose of this was to show a ceiling. I see. I think that explains it.

THE CHAIRMAN: What is the figure just given by Mr. Cooper about the amount held by the public? I see \$760,000,000. Does it happen to be the same figure, about?

MR. COVERT: No. \$584,000,000 I think it is.

THE CHAIRMAN: The amount held by the public; and it is the public we are concerned with. And that amount should read \$584,000,000 and not \$760,000,000? Is that right?

MR. O'DONNELL: Yes, I think so. That is, the second figure on page 13, instead of being \$760,494,825.11, it should read \$584,232,268.

MR. COVERT: Q. And on the same page, Mr. Cooper, in connection with the same thing, I notice that in the last paragraph, Mr. Gordon submitted as follows:



"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital. However, in view of the practical difficulty in the way of converting the interest-bearing capital in the hands of the public into equity capital at this time . . ."

I suppose you are, perhaps, in somewhat the same position that you were before; but half a loaf is better than no loaf, and this ceiling is given so that perhaps you may come back again?

A. I do not think so. I do not think there is any suggestion that it is a half-way adjustment.

Q. Mr. O'Donnell says it is for once and for all?

MR. O'DONNELL: This is the adjustment of adjustments. We have been waiting for it for thirty years.

THE WITNESS: If we were tied down to the \$584,000,000, because that is held in the public, and we said we cannot touch that, we must go on with it on our shoulders as a burden, we would say it is only a partial adjustment. But the introduction of the \$300,000,000 figure is a method by which we can get around the difficulty that always existed in any attempt to adjust the capital structure of the railway.

THE CHAIRMAN: You show here how you would reduce it?

MR. O'DONNELL: In so far as the debt in the hands of the public is concerned.

THE CHAIRMAN: It could be "drawn on from time to time to retire interest-bearing obligations in the hands of the public"?

THE WITNESS: Yes, sir.

THE CHAIRMAN: Q. "Or for capital additions to the property"?





A. And if that adjustment were carried through, as it might be in a few years time, and had been all eaten up by debt retirement, then we would have brought our funded debt in the hands of the public down to a point where we think it should be.

MR. COVERT: Q. That is, approximately, the \$584,000,000 less the \$300,000,000?

A. Yes, sir.

Q. Now, on page 15 --

THE CHAIRMAN: Q. I think we might as well inquire as to what is the value or use of this:

"The necessary amount of equity stock to be given to the Government." Does that mean anything?

A. Not a great deal, Mr. Chairman, no.

MR. COVERT: That is in paragraph 2 on page 15, my lord. That is really, I suppose, a method of balancing your balance sheet, putting the \$300,000,000 on one side as against --

THE WITNESS: Yes, without reducing our total capitalization, yes.

MR. COVERT: Q. Yes, and in effect what it does is to enable you to raise \$300,000,000 of equity capital?

A. And use the proceeds either for the redemption of debt, or for additional capital expenditure.

Q. That is the purpose of it?

A. That is correct.

Q. In paragraph 3 on page 15 Mr. Gordon refers to this:

"Future development lines should be financed to the extent of not more than 60 per cent by interest-bearing securities, the balance to be supplied by the Government against the issue by Canadian National of



a commensurate amount of equity stock." .

That would mean that if you borrowed, let us say, \$100 for that purpose, \$60 of it would be in bonds, and \$40 of it would be in stock. And if you obtained, for instance, your bonds at 3 per cent, you would be borrowing the \$100 at an interest rate of about 1.8 per cent?

A. Yes.

(Page 18718 follows)



THE CHAIRMAN: In those lines I also understand are lines to be selected by the Railway itself for building, not to be imposed upon it in any way. Isn't that the result of what Mr. Gordon added?

MR. COVERT: Yes, I was going to deal with that, Mr. Chairman. You will find it on page 18387 of the evidence. Mr. Gordon said:-

"In saying what I have just said on this particular point, I would definitely wish to emphasize and make clear that there is no intention on the part of the Canadian National Railways to undertake the construction of any and all railways which might in the future be suggested, even if 40% of the capital were to be provided by way of equity stock. The Canadian National Railways should be free to consider on its own merits each individual case of developmental line which might be proposed in the future."

Now, I thought that perhaps that might have a little clarification when he says "might in the future be suggested". I just wondered, "suggested" by whom?

A. What was that page?

Q. It is right at the bottom of 18387.

A. Well, the President wished to make it perfectly clear that because he had said that not more than 60% of the cost of development lines should carry an interest charge, he was not inferring that assuming that arrangement were offered to the Canadian National Railways, that he would automatically agree to the construction of the line. He feels that each project should be considered on





its merits, and that the management of the Canadian National should be free to decide whether it will or it will not go ahead with such a project.

Q. Yes, I think that may be very important, Mr. Cooper, because in other words, if the capital is to be put up by the Government, the whole of it, and if they suggested a line, the position that Mr. Gordon then takes is, that the management of the Canadian National Railways would consider it on its merits and would have the right to say "no".

A. That is the policy of the Canadian National Railways in these matters, yes.

Q. Do you think as a practical question that any owner of 100% of the stock can be said "no" to?

THE CHAIRMAN: Would you please repeat that?

MR. COVERT: I asked as a practical matter if you could say "no" to the owner of 100% of the stock, lending the money. I just wanted to find out.

A. In my opinion one could say "no" and one could hold that position with a degree of strength.

Q. Now, Mr. Cooper, I want to come back to these surplus earnings again.

THE CHAIRMAN: Pardon me a moment then. Would this limitation on the obligation of the Company to build new railways apply also to taking over railways, if there are any left, which are insolvent or for other reasons unremunerative - which form part of your case, you see.

A. I think the railway management would wish to have some freedom as to whether it should or should not take over.



Q. When you say "some freedom" I presume you mean "all freedom"?

A. No, sir, I think that a point can be reached, as was reached in the case of Newfoundland - -

Q. Well, isn't that what Mr. Gordon must be taken to mean in this interjection of his after paragraph 3:-

"...there is no intention on the part of Canadian National Railways to undertake the construction of any and all railways which might in the future be suggested.... The Canadian National Railways should be free to consider on its own merits each individual case of developmental line which might be proposed in the future."

I am wondering then whether the same policy is desired by you in the case of lines which are not to be built, or which are there and which are unremunerative, insolvent or otherwise undesirable which you might be asked to take over?

A. I think that can be inferred, my lord, yes.

MR. O'DONNELL: Some arrangement would have to be made equitably.

MR. COVERT: Q. To preserve that freedom should there be some statutory provision?

THE CHAIRMAN: Perhaps, Mr. O'Donnell, you could tell us more about this?

MR. O'DONNELL: I assume what Mr. Cooper has in mind - -

THE CHAIRMAN: No, it is what Mr. Gordon had in mind.





MR. O'DONNELL: Yes, but with respect to what Mr. Gordon has in mind, is that any line which it might be suggested should be taken over by the Canadian National should be taken over on terms. There would have to be some allowance made by reason of the fact that it was an unremunerative proposition, some equitable adjustment so that the overall position of the Canadian National would not be adversely affected.

THE CHAIRMAN: In the result would the Canadian National have the final say as to whether or not - -

MR. O'DONNELL: Well, I don't suppose it would.

THE CHAIRMAN: Well, somebody must tell us, you see.

MR. O'DONNELL: Mr. Gordon's paragraph there relates solely to future development lines.

-THE CHAIRMAN: No, it relates solely to lines to be built, and if I understand Mr. Gordon's statement he says it is the railway who should decide whether or not a new line will be built. Now running throughout this case there are the difficulties which arise over the taking over of unremunerative or insolvent lines by the Company, and I am just wondering whether this attitude taken here by Mr. Gordon is intended to apply to the taking over of other lines. I don't know whether there are any left in Canada I must say, but if there are.

MR. O'DONNELL: Well, as your lordship remembers, under the Canadian National Railways Act, Chapter 172 in the Revised Statutes 1927, there is that provision for the entrustment by Order-in-Council to the Company of the management and operation of any railway property or works vested in



His Majesty. I would imagine that Mr. Gordon would certainly be inclined to make the best deal possible in any circumstances where the entrustment of a railroad were to be given to him.

THE CHAIRMAN: The point is important in this way. We are looking to the future, you see, and I think Mr. Cooper just said there is no intention of coming back again from time to time. Now, what is the desire of the corporation for the future? Is it to be left entirely free both as to the branch lines it may build and as to other lines which it may take over? What I am saying now, you see, Mr. O'Donnell, may have to do with an amendment of that Act.

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: But I think it is very important for us to know.

MR. O'DONNELL: I would be glad - -

THE CHAIRMAN: You see, the point is, how do you want to be placed for the future? It is not enough to re-cast your capital structure, but what are to be your obligations? If you would still have to go on taking over insolvent and unremunerative lines, well, that is one thing; if you are liberated from that, it is another thing.

MR. O'DONNELL: Well, I would say this then. I don't think that Mr. Gordon's statement with respect to page 15 was dealing with that particular aspect of the matter. I should be glad to get instructions.

THE CHAIRMAN: He confines it to the question of building new lines.



MR. O'DONNELL: That is right.

THE CHAIRMAN: But it is certainly very closely related to the other.

MR. O'DONNELL: That is right, my lord, and I will be glad to get information and provide it.

MR. COVERT: It seemed to me there would be two points involved: one is what freedom they want in both of these cases, and second, if there is any statutory provision required to give them that freedom.

THE CHAIRMAN: That is the point.

COMMISSIONER INNIS: Would the same rights be given to the Canadian Pacific?

MR. O'DONNELL: Well, I think the Canadian Pacific is a free agent as far as that is concerned. It does not have to take anything it does not like.

COMMISSIONER INNIS: But you might have a situation in which people in the Canadian National territory were perhaps getting branch lines under advantageous conditions such as people in the Canadian Pacific territory would like to get.

MR. O'DONNELL: Well, I suppose that is something that would have to be considered too. I think all Mr. Gordon is trying to do there, is to say: "I don't want to have a whole array of development lines being foisted on to the Canadian National without some adequate arrangement being made on an equitable basis to provide the capital that would be required to run them."

THE CHAIRMAN: Well, we will expect to hear from you later.

MR. O'DONNELL: Yes, my lord.

MR. COVERT: Q. Mr. Cooper, I want to take up





this subject that appears right after that under the heading "Surplus Earnings" and it is a matter we discussed this morning, so rather than have to call you again, I thought that I might assume a figure and then you could give me the answers with respect to that figure and we could apply them to the statements which you are going to submit. What I would like to do is, assume, for instance, in (a) which is to provide sufficient funds to cover expenditures for non-revenue producing improvements and betterments; if we assume that figure were in the neighborhood of say \$15 million a year and then you took that for the seven-year period from 1940-1946, that would total \$105 million; and applying that to the figure which we arrived at this morning of about \$238 million and deducting the 105 from the 238, that would leave a surplus for the stabilization fund of 133 million. If this reduction of the funded debt had taken place in 1939, (that is, without taking into consideration the \$300 million item); what I wanted to ask is that if that were the position in 1946 would you not be in this position, following Item (b):-

"To establish a rate stabilization fund which it is hoped could be built up in good years and drawn upon in poor years with a view of affording stability to the rate structure and tending, to the extent of the fund from time to time existing, to postpone the necessity of applications for general freight rate increases."

Now, my point would be this, that you might possibly find yourself in years equally as good as those again, for example if there were another war. That would mean that you might under similar circumstances



•  
have a stabilization fund of approximately \$133 million. Do you think under circumstances such as those, that Canadian National could apply for a rate increase or could join with the Canadian Pacific in applying for a rate increase?

A, I would again prefer that this section of the statement be dealt with by Mr. Fairweather. Mr.

Q. That is fair enough. May I just leave it at this, that if my figures are correct, that is the way it would work.

A. You are correct this time.

(Page 18726 follows)



Q. Now I wanted to deal for a moment with uniform accounting. Have you your main submission there?

A. Yes.

THE CHAIRMAN: You are on the brief now, are you?

MR COVERT: That is right, sir. It is the second paragraph on page 105, where it is said:

"It is respectfully submitted that in any revision of the Canadian accounting classification, Canadian National be permitted to continue its present practice."

Q. Now, I think you are referring there to the renewal method for roadway depreciation, are you not?

A. No, sir; I am referring specifically to depreciation accounting on rolling stock.

Q. On rolling stock?

A. Yes, sir.

THE CHAIRMAN: Q. The Canadian accounting classification, you say that applies to rolling stock?

A. Yes, sir.

Q. Only?

A. Yes, sir. I went on further to deal with the application of depreciation accounting to roadway property, beginning where you---

MR COVERT: Q. Where I started?

A. That is right.

MR O'DONNELL: Where you left off.

MR COVERT: Q. Now, with respect to roadway property, then, Mr. Cooper, am I wrong, that Canadian National takes the view that depreciation accounting is not necessary for roadway property?

A. Very definitely.

Q. Then could not we apply that same recommendation with equal force to both, or does it mean that---





THE CHAIRMAN: The definite statement is that depreciation accounting is not proper practice---

MR COVERT: For roadway property.

THE CHAIRMAN: Q. That is right, is it?

A. Our position, sir, is that with respect to rolling stock there should be depreciation accounting, it should be mandatory, and it should be on the straight line method. With respect to roadway property, we prefer that there should not be depreciation accounting at all.

MR COVERT: Q. Now, what I want to find out is, is it your view then that as far as roadway property is concerned there should be an exception to uniformity -- that is, that one road should be permitted to have depreciation accounting apply to roadway property and the other continue on renewal method?

A. If we were asked for our opinion we would say that both railways should have uniform accounting with respect to roadway property, which means in effect that there should not be depreciation accounting for roadway property with either company.

Q. I think I follow you, then, Mr. Cooper. You say that from your point of view it would be preferable if there would not be depreciation accounting for roadway property for either road, and that the uniform accounting should so provide?

A. That is my opinion, yes, my recommendation.

THE CHAIRMAN: Q. You say that rolling stock should be straight line depreciation?

A. Yes, sir.

Q. Should that be made compulsory for both railways?

A. In my opinion, yes, sir.

MR COVERT: Q. In the United States on your U. S. roads you do have depreciation accounting on roadway pro-



property, do you not?

A. Yes, but not on the track, of course.

Q. Generally in the United States there is depreciation accounting on roadway?

A. Other than the track structure, yes. It is mandatory under the---

Q. And you think that Canada should differ in that respect?

A. I do.

THE CHAIRMAN: Mr. Covert, there must be some reason, then, why Mr. Cooper does not think it would be advisable to have the two railways left free, one on straight line depreciation and the other on user depreciation.

THE WITNESS: Yes, sir. If I may be permitted to read my views I would appreciate the opportunity to do so, because I think this matter of depreciation accounting is undoubtedly about as difficult a problem as there is in railroad accounting.

One only needs to consider the prolonged efforts on the part of the Interstate Commerce Commission to carry out the instructions of Congress in this regard. It was on February 28, 1920, that paragraph 5 of section 20 of the Interstate Commerce Act in its present form was enacted. In Order 15100 it is stated, at page 325:

"Prior to 1920 our power over depreciation accounting was vague and discretionary. The amendment of 1920 made the power definite and its exercise mandatory.

The amendment is in no way inconsistent with prior provisions of section 20. It clarifies and amplifies those provisions so far as depreciation accounting is concerned." It took the Commission fifteen years, that is, to January 1,



1935, to prescribe depreciation rates for equipment, and it took the Commission twenty-three years, that is, to January 1, 1943, to prescribe the classes of roadway property and the applicable rates. Although they were under direction from Congress to prescribe the rates, nevertheless it took them twenty-five years to decide what should be done.

There should not be any serious concern, therefore, if this matter of mandatory depreciation accounting for Canadian railways is not determined in the course of a few weeks or months.

It may be said that the straight line method is in almost universal use. This does not prove it to be the best method. Nevertheless, when business managements free to adopt any reasonable method elect to use the straight line method, such general acceptance is entitled to great weight in considering the merits of the various methods.

We are not, however, here concerned with a consideration of all the various methods named. The questions to be decided are, <sup>(1)</sup> for which classes of property the Board shall prescribe the use of depreciation accounting, <sup>(2)</sup> whether the methods shall be optional or mandatory, and <sup>(3)</sup> whether the method shall be the straight line method or the production or user method. It is thought that this subject might more conveniently be discussed, first with respect to rolling stock, vessels and vehicles, and secondly with respect to fixed assets.

As to rolling stock, vessels and vehicles, we think the Board should prescribe depreciation accounting, which should be mandatory and not optional, and should be computed on the straight line basis.

As to fixed assets, we think the Board should not prescribe depreciation accounting, nor should it be





optional on the part of the carriers..

Dealing with rolling stock, both Canadian railways have adopted depreciation accounting for <sup>railway</sup> rolling stock.

The Canadian National compute their charges by the straight line method. They have adopted a rate of 3-1/3% per annum applied to ledger values. The average of rates used by Class I roads in 1947 was 3.3per cent. In 1948 it was 3.31 per cent. So our rates are identical with those of the Class I roads. The Canadian Pacific compute their charges on a user basis. The only question appears to be which of the two methods is to be used, assuming uniformity is to be enforced.

I would now like to make a comparison between the straight line and the user method. The arguments we see in favour of the user method are as follows:

For classes of property the service life of which is exhausted to a greater degree by use than by other factors, the user method appears to be the more accurate measurement. This is not true, however, unless the use factor exceeds 50 per cent of all factors compelling ultimate retirement.

Under the user method the carrier's opportunity to recover the depreciation costs is greatest when business activity is at its peak.

There will be tax benefits by having larger deductions during periods of high earnings.

Those are the arguments which I see in favour of user depreciation.

The arguments we see against the user method and in favour of the straight-line method are as under:

First, wear and tear are not the only factors in depreciation. The use basis seems to attach little importance to the action of the elements and decay in causing



exhaustion of service life; obsolescence and inadequacy also are important factors. Our engineers tell me that in their opinion rolling stock is kept in better condition when it is in use and that deterioration takes place rapidly when equipment is held out of service for long periods of time.

Use, in excess of normal or average, entails maintenance and repair expense in excess of normal or average. By the periodic shopping of equipment the greater part of deterioration as the result of use is restored. If equipment is kept in first class condition, use and restorative repair costs go hand in hand. It is the exhaustion of service life not restored by current maintenance for which depreciation accruals are intended and it is difficult to prove that exhaustion of service life not restored by maintenance is brought about by use to a greater extent than by the other factors involved.

I would point out that the straight-line method comprehends the effect of use but only to the extent it cannot be restored by repairs and renewals.

My objection Number 2 relates to the difficulty of its application. I have assumed that under the use method the depreciation charge for any year would be found by taking the ratio of service value which the equipment unit mileage or gross ton mileage for the year bears to the estimated potential mileages during the estimated service life of the assets. It is difficult enough to estimate service lives in units of time. We have some knowledge of the service lives of units which were built 30 or 40 years ago but that knowledge gives little indication of the potential service lives of the kind of equipment being built today. It seems to me an added difficulty and a serious one to have to make a forecast of the potential



run-out mileages or gross ton mileages over a period extending 30 or 40 years into the future. Estimates of future productivity require a knowledge as to engineering improvements tending to lengthen the service life of equipment, also changes in retirement and maintenance policies which may shorten or lengthen the life of property. Rates of growth and cyclic swings in the traffic handled must be taken into consideration. A correct appraisal of these factors is extremely important under the group method of depreciation as there is no automatic cut-off of the depreciation charge, if and when a unit of property is written out of the investment account. The drastic swings in traffic volume such as we witnessed in Canada during the depression and the war years would play havoc with any estimated trend of traffic growth extending far into the future. It was brought out in evidence in the 30% rate case that the computation of depreciation rates on a user basis involved a tremendous amount of clerical effort and a voluminous amount of paper work.

My third objection, sir, is the difficulty of regulation. It is essential to regulation that the authority shall be in a position to examine the data on which the rates are computed, not only for the initial rate but also for the revisions which are necessary from time to time under changing conditions.

(Page 18734 follows)





I feel that the difficulties on the part of the carriers in establishing and revising the rates to which I have referred would be extended and enlarged for the regulatory authority because they would have to work outside instead of inside the railway organization.

So far as I know there is only one railway using this method. The Interstate Commerce Commission require the straight line method. While the Commission stated in Order 15100 that the user basis might be considered an alternative method, nevertheless, in their order they prescribed the straight line method. It seems obvious that no carrier has been able to develop a plan which the Commission consider to be practical.

I, personally, was informed by the Chief of the I.C.C. Depreciation Section that in no case had the Commission authorized the use basis, that several carriers had submitted plans, but on discussion with the Bureau, had accepted the Bureau's views that they were not acceptable and had withdrawn them.

I might say that when the Canadian National was contemplating the adoption of depreciation accounting in 1940, I went down to Washington and spent a number of days with the depreciation experts of the Interstate Commerce Commission. I raised this question of use with them and the reference to the user method in Order 15100, and that is what the Bureau told me; namely, that a few carriers had approached them with regard to the possibility of adopting the user method, but that after hearing all they had to say, they decided there was no use in adopting it at all.

The new British Transport Commission have adopted depreciation accounting for rolling stock computed on the straight line basis.



The Interstate Commerce Commission say of the straight line method: "This is the simplest and the one most generally used."

From a summary of conclusions and recommendations contained in a report of the Committee on Depreciation of the National Association of Railroad and Utilities Commission, 1943, the following extracts are taken, but perhaps I should first file this report as an exhibit.

MR. COVERT: It will be Exhibit No. 249, and it is entitled "Report of Committee on Depreciation, National Association of Railroad and Utilities Commissioners."

EXHIBIT 249: Filed by : Report of Committee on  
Mr. Covert: Depreciation - National  
: Association of Railroad  
: and Utilities  
: Commissioners.

MR. O'DONNELL: My friend has just asked me for copies of this exhibit. I wired to Washington and asked for copies of it, but it is out of print. It was printed in 1943. I wanted to get copies, but I just could not do so. I am sure that my friends have it in their archives, however, I am unable to supply copies.

MR. EVANS: I would like to borrow a copy of it because I think I will have to ask some questions about it, and I have never seen it.

MR. O'DONNELL: I wired to our agent in Washington and asked him to get copies of it. We will let you have that one.

THE CHAIRMAN: And Washington told you it was out of print?

MR. O'DONNELL: Washington told us it was out of print. It was printed in 1943.

THE CHAIRMAN: What is the title of it?

MR. COVERT: It is entitled, "Report of Committee on Depreciation - National Association of Railroad and



Utilities Commissioners," 1943.

THE WITNESS: And in my opinion it is the most authoritative write-up on this subject of depreciation accounting that I have ever seen.

THE THE CHAIRMAN: What year is it?

MR. COVERT: 1943, my lord.

THE WITNESS: I am going to read from page 16 and page 17 in Roman numerals. These pages contain their conclusions and recommendations. I quote:

"21. The straight-line method is in very general use and is in the ascendancy in the public utility field.

22. The straight-line method is simpler than, and is as not as seriously affected by errors in estimates of service lives as the interest methods.

26. The straight-line method is generally recommended for public utility accounting and financial purposes and also for the computation of both depreciation expenses and accrued depreciation for purposes of rate making."

Now, with respect to fixed assets:

The Canadian National have not adopted depreciation accounting for fixed assets. The Canadian Pacific have adopted depreciation accounting for fixed assets, other than the track elements (rail, ties, ballast, and other track material), their depreciation charges being computed on the user basis.

In recommending that depreciation accounting shall not be prescribed for fixed assets, we have had the following considerations in mind:

The Interstate Commerce Commission was directed by the Congress in 1920 to prescribe the classes of property for which depreciation accounting should be





required. They held lengthy hearings; they prepared proposed orders which were modified several times, but it was not until January, 1943, that they issued their Order requiring the carriers to accrue depreciation on roadway property.

That is to say, it took the Commission, with all their experts and technicians, twenty-three years to reach a conclusion on this difficult subject. Even then they realized their instructions were not final.

They appreciated that it was illogical to require depreciation accounting for such property as stations, shops, bridges, culverts, fences, etc., and at the same time leave the track elements, rails, ties, ballast and other track material, to be accounted for on a replacement basis. The track elements above all else are subject to physical depreciation -- much more so than the classes of property for which depreciation accounting is prescribed.

The Commission is not happy about the situation in which they find themselves. In 1948 they advanced a proposal that depreciation accounting be extended to rails, ties, and other track material. In my opinion the chances of this proposed Order ever being made effective are very slim. I feel certain it will be strenuously resisted by the carriers.

What to do about ballast is another problem for which no solution has yet been advanced.

It seems to me that the Canadian authorities would be wise to wait until the situation in the United States has become stabilized.

In our annual report for 1942 we stated the change-over to depreciation accounting by the United States carriers constituted an important departure from a long established practice and that it seemed advisable



to wait until the experience of the United States carriers is available. This was not said merely to cause delay, it stemmed from the conviction that the problem had not been solved by the Order issued at that time. I think this has proved to be the case.

I consider the Canadian carriers should not get entangled in a confused state of affairs until the final outcome is more clearly defined. The problem creates administrative, accounting and engineering difficulties, it gives rise to disputes between the carriers and the regulatory authority, and between the carriers and the tax authorities. It creates financial difficulties because of the disparity between the costs of original installation and replacement.

It may be thought there is an inconsistency in the position we are taking, in that we are suggesting on the one hand the Canadian classification should be uniform with that of the I.C.C., and on the other hand we are asking for an exception in the case of depreciation accounting applied to roadway property. It is all a matter of degree. If there is an inconsistency I am pointing out our reasons for thinking an exception is justified.

These reasons, for me at any rate, are relevant and convincing. I am suggesting ours is a logical inconsistency.

Uniformity is desirable but only to the extent found reasonable. The price for enforcement of strict uniformity may be too high and in relation to the results achieved, not worth while.

In the complexities of modern business special arrangements to meet peculiar conditions are often necessary. For example, if simplicity is carried too far



in income tax legislation, the result may be unequal treatment as between one taxpayer and another. The Interstate Commerce Commission from 1907 have required depreciation accounting for rolling stock but it was not until 1943 that they required depreciation accounting for roadway property. They thought the conditions with respect to the two classes of property called for different treatment.

THE CHAIRMAN: When was depreciation on rolling stock begun?

A. 1907, sir.

The British Transport Commission have decided to use depreciation accounting for rolling stock, vessels and vehicles, but have decided not to use it for fixed assets, and I do not believe they have made such a decision without the most careful consideration.

Q. Can you tell us whether they adopted the straight line?

A. With respect to rolling stock, yes, sir; but they have not adopted depreciation accounting for roadway property. They have turned their backs on it.

I might say that when the British Transport Commission was organized, there was entrusted to that Commission all the railways of the United Kingdom, considerable of their highway transport, their docks, their canals, their shipping, and the London Transport.

Prior to the combination, there were a number and of activities/they had a variety of systems, and they had to decide at a very high level the policies that they would adopt in matters of this sort. And they elected, as I have said, that with respect to rolling stock, they would adopt depreciation accounting on a straight line method, but with respect to fixed property,





they would adopt the replacement method.

That was only two years ago. And I give the British authorities credit for knowing what was best to be done.

I consider the importance of this matter has been overstated. For the Canadian National it means at the most a matter of \$4 millions a year; it might very well be much less. \$4 millions a year is less than 1 per cent of our operating expenses.

The composite rate of the Class 1 roads expressed as a percentage of investment in property subject to depreciation accounting was 1.59 in 1948.

Expressed as a percentage of total road property investment the charge was 0.71, that is, seven-tenths of one per cent.

For Canadian National lines in the United States-- and we have about 1,785 miles of railroad in the United States -- the percentage was 0.68.

The percentage for Canadian National lines is only 3/100ths of one per cent less than the average of all the Class I roads.

If I use the rate for our lines of 0.68 per cent and apply it to the book investment in roadway property for our lines in Canada, the resulting annual charge would be \$8,894,000.

Against this one would have to allow the amounts actually charged in the accounts to expenses and under which under depreciation accounting would have been chargeable against depreciation reserve.

In 1948 these amounted to \$4,212,994; and in 1949, they were \$4,608,569.

On this basis the additional charge to expenses to put us on all fours with the Interstate Commerce

the first of the following methods.

1. The first method is the most common.

2. The second method is the most common.

3. The third method is the most common.

4. The fourth method is the most common.

5. The fifth method is the most common.

6. The sixth method is the most common.

7. The seventh method is the most common.

8. The eighth method is the most common.

9. The ninth method is the most common.

10. The tenth method is the most common.

11. The eleventh method is the most common.

12. The twelfth method is the most common.

13. The thirteenth method is the most common.

14. The fourteenth method is the most common.

15. The fifteenth method is the most common.

16. The sixteenth method is the most common.

17. The seventeenth method is the most common.

18. The eighteenth method is the most common.

19. The nineteenth method is the most common.

20. The twentieth method is the most common.

21. The twenty-first method is the most common.

22. The twenty-second method is the most common.

23. The twenty-third method is the most common.

24. The twenty-fourth method is the most common.

25. The twenty-fifth method is the most common.

26. The twenty-sixth method is the most common.

27. The twenty-seventh method is the most common.

28. The twenty-eighth method is the most common.

29. The twenty-ninth method is the most common.

30. The thirtieth method is the most common.

Commission requirements is from \$4 million to \$4½ million.

I do not think that is the end of the story.

I am far from being convinced that the charge to expenses under depreciation accounting is not excessive.

A senior officer of the Interstate Commerce Commission recently told me he was disturbed to find that the credits to depreciation reserves were running about three times the amount of retirements charged against the reserves. He said that the average life of their railroads exceeded sixty years and therefore it was reasonable to assume a degree of stabilization had been reached and that retirements are now taking place according to their normal service life expectancies.

Perhaps the depreciation rate is too high; perhaps much of the expenditure which should be charged to depreciation reserve is being absorbed in the maintenance accounts. That is a matter which the carriers must find great difficulty in controlling and certainly one which the regulatory authority would find great difficulty in checking.

That is why I say that even with depreciation accounting you have no assurance you have a more correct charge in operating expenses than if you charge out replacements and retirements as they occur.

Perhaps the truth lies in between, but I think I am entitled to claim that our present accounting is just as realistic as it would be if we had depreciation accounting for fixed assets.

It is my opinion that if for rate making purposes the Canadian National accounts are to be used, and if an adjustment is necessary as between our present basis of accounting and the depreciation basis, a simple adjustment by an agreed lump sum figure can readily be





made, and that would be the sensible thing to do, rather than to inflict so much difficulty and expense on the railway in going through the tremendous effort of computing a theoretical depreciation expense.

I do not claim or suggest we have reached a state of perfection or that we are infallible. I have mulled over this problem many times. Its solution is far from clear.

I am inclined to think we should move over to the replacement accounting basis, I am speaking now of course only of roadway property.

At present Canadian National is on one basis, the Canadian Pacific is on another, the United States railroads on another, and the British railways still different.

I like the British method best. They deal with the problem with a great deal of common sense. They see through this mental maze about depreciation theory and practice. They largely avoid capitalizing changes in the price level.

The British proceed on the assumption that the railway -- not its equipment -- is something that can be permanently maintained by repairs and renewals and that its capital account changes neither up nor down unless the undertaking itself expands or contracts; changes in the price level when capital assets wear out and are replaced, repairs and partial and complete renewals being charged to expenses as incurred.

Only expenditure on additional assets and on the improvement of existing assets is charged to capital account.

This principle is presently followed by the Interstate Commerce Commission in the case of the track





structure, meaning the rails, ties, ballast, tie plates, joints, bolts, spikes, etc. It also applies to the replacement of small units of property where the charge to capital account would be less than \$500 for any one unit.

In the British method there is no such ceiling.

I think the possibility should be explored of incorporating the British principle in the proposed Canadian classification. To the extent units of property are replaced in kind the cost should be treated as an operating expense, and only the cost of betterment, improvement or enlargement added to investment.

(Page 18754 follows)



THE CHAIRMAN: Well, do you think you have covered the point that you began with? You remember I asked you whether you saw any objection to allowing each railway to select its own method (talking of rolling stock now) either straight line or the user method as is being done now; and you said it was objectionable. Have you covered that, do you think?

A. I think if you are to ensure uniformity of accounting that on the matter of depreciation accounting for roadway you would either have to have it or you would - -

Q. I am not talking so much of roadway now, as of rolling stock.

A. Well, we both have it.

Q. Well, you have straight line.

A. Yes.

Q. And the other railway has the user.

A. Yes.

Q. And the point we began with was whether there was any objection to both companies being allowed to carry on that way, each selecting its own method of depreciation. You said you were against that, which is because of some interference with uniformity. Is that the only thing?

A. It cuts across the principle of uniformity.

Q. Yes, but otherwise there is no harm done to your company by allowing freedom, is there?

A. No, sir, we are perfectly happy to go our own way and let the Canadian Pacific go theirs. We have no desire whatever to inflict our ideas on the Canadian Pacific. We are merely answering a question which has



been put to us: Do you think there should be uniformity of accounting? We are not raising the question, we are only answering it; and if the question is put to us that way, I say our duty compels us to say that we think there should be uniformity and it should be on the straight line method.

COMMISSIONER INNIS: Do you discuss at all the problem of capital? We have heard a good deal from the Canadian National and the Canadian Pacific as to the problem of getting capital outside. Doesn't the system of depreciation have something to do with the problem?

A. In the obtaining of capital, that is?

Q. Yes.

A. Yes, it does.

Q. Would you go so far as to say that considerable freedom should be allowed to each railroad since the capital problem is important?

A. My submission is that I think the difference in the end result under the two methods is not worth all this while. It may be that under the user method the charge to expenses might be a little more than under the straight line method in times of above average traffic conditions and a little below if traffic conditions are a little less normal.

Q. Would you be content to let the income tax authorities prescribe the type of regulation?

A. No, sir. I might say on that that in the United States the Internal Revenue Department makes its own rules and they do not necessarily recognize the rules of the Interstate Commerce Commission. You have two departments of Government with their own differing theories,





insisting that for accounting purposes one thing shall be done and with respect to tax returns a different thing shall be done.

If I might just continue, sir, my thought on this is that with respect to rolling stock the only difference between us is: Do we have user or straight line method? With respect to roadway property, my suggestion is that the British method might be considered. Somebody should take a look at it and see if it is suitable for adoption in the Canadian Classification.

I have not reached a final conclusion myself that that is so. I believe that under a replacement method the charges to operating expenses might be in excess of those of the straight line or the user method.

Q. You mean the nationalization of railways in England? That is the type of accounting that you refer to?

A. Yes.

Q. Not the private enterprise era?

A. There are not any private railways in England of course.

MR. COVERT: What I was coming to on that, Mr. Cooper, is that the British method does apply to entirely State-owned railways?

A. Yes, that does not change the fact.

Q. You say that doesn't matter?

A. I don't think it does.

Q. I see. I thought you were of the opinion that different considerations applied in the case of a State-owned railway and a private enterprise so far as depreciation is concerned.



A. There are so many different views on depreciation accounting that I don't think the practice here or there is necessarily controlling.

Q. No, but I suppose depreciation is a more practical problem from the point of view of the private company which has to pay income tax, as against a State-owned one that does not?

A. I don't think so, unless the income tax people were to refuse to allow a depreciation charge which is not entered in the accounts. Now, that also needs some qualification. I think it is possible (I am sure it is done) that a lot of Canadian Companies (although this is a bit outside my experience) keep their books one way, and for income tax purposes they make an adjustment. I think that it would be possible here, but when you come to the taxation question, if any justification for a difference in method as between the Canadian Pacific and the Canadian National is thought to rest on the fact that the Canadian Pacific pays taxes and the Canadian National do not: then I wish to say to the Commission that as far as we are concerned we are willing to be made subject to income taxes too. If you adjust our capital structure, put us on a parity with the Canadian Pacific in respect of those matters, we are satisfied to be put on a parity with them with respect to matters such as income taxes. But, we do object, we have always objected, or we have always resisted the criticism directed against us because we did not pay tax, when we had the burdens on us that we have been talking about. The tax burden I don't think compares with the interest burden that we have been



expected to carry.

Q. Now, just before we get on that, Mr. Cooper, I would like to finish, if I could, this particular matter. First, is the important thing in your view, as far as comparison is concerned, - is the important thing that the railways should have to depreciate the same property?

A. I think we should have uniform accounting.

Q. I understand that.

A. I mean in the state in which it is uniform in the United States. The Interstate Commerce Commission have prescribed there what the carrier shall do, both with respect to rolling stock and with respect to roadway property. They do not make any exception; they do not say that one carrier shall have an option of doing this and another shall have a different method. They say "uniformity - you all go on the straight line method without exception". Now, if we are going to have uniform accounting in that sense, then I don't think you can have options.

Q. With respect, that is not what I was discussing. I asked you if, from the point of view of comparison, the important thing was they should be depreciating the same assets?

A. Yes, that is in line with my argument.

Q. Yes.

THE CHAIRMAN: That is to say, if one is to depreciate railway property, the other one also should depreciate railway property?

MR. COVERT: Yes.

THE WITNESS: Yes.





Q. If both companies are depreciating the same property, then even if they were on different methods you might make comparisons quite simply?

A. What we fear, of course, is the possibility that the regulatory authority in deciding what rates and methods shall be used, might inflict user depreciation on us. Now, we would fight that to the very last.

Q. What I asked, Mr. Cooper, was that if the same properties were depreciated in both roads, would it not be quite possible to make simple comparisons, even if they were on different methods?

A. It is a matter of degree, as to how fine you want this uniformity to be. If it is understood that one carrier has user depreciation - -

Q. Let us take one example. Supposing both were having their rolling stock on depreciation accounting.

A. Yes.

Q. Supposing you were on the straight line method and the Canadian Pacific was on the user method.

A. Yes.

Q. You would easily be able to make comparisons, wouldn't you, of the results of the operations for the two roads as far as that is concerned?

A. As far as depreciation is concerned?

Q. Yes.

A. You would certainly be able to see what the figures were, but you would not say you were on equal terms; you would not say that you were stating; your operating expenses on an equal basis.

Q. No, but couldn't you, Mr. Cooper, take, for instance, the straight line of the C.N.R., look at it



and find out what it is, and apply the same to the Canadian Pacific, as long as the same property is being subject, and make a comparison. Could not you really apply the same to the C.N. and thus make a comparison, even if they were on opposite methods?

A. That is possible, yes.

Q. And quite easily?

A. I understand that was done in the rate case.

Q. Yes. As I say, as long as the property subject to depreciation is the same, the matter of comparison of the two is not a very difficult matter, is it? The real difficulty arises when one is on depreciation accounting, for instance, on roadway property, and the other is not. Then you cannot compare.

A. I do not agree with that at all.

Q. You don't?

A. No, I think <sup>the</sup> margin of error or the difference between user and straight line might be equally as great as between depreciation and replacement.

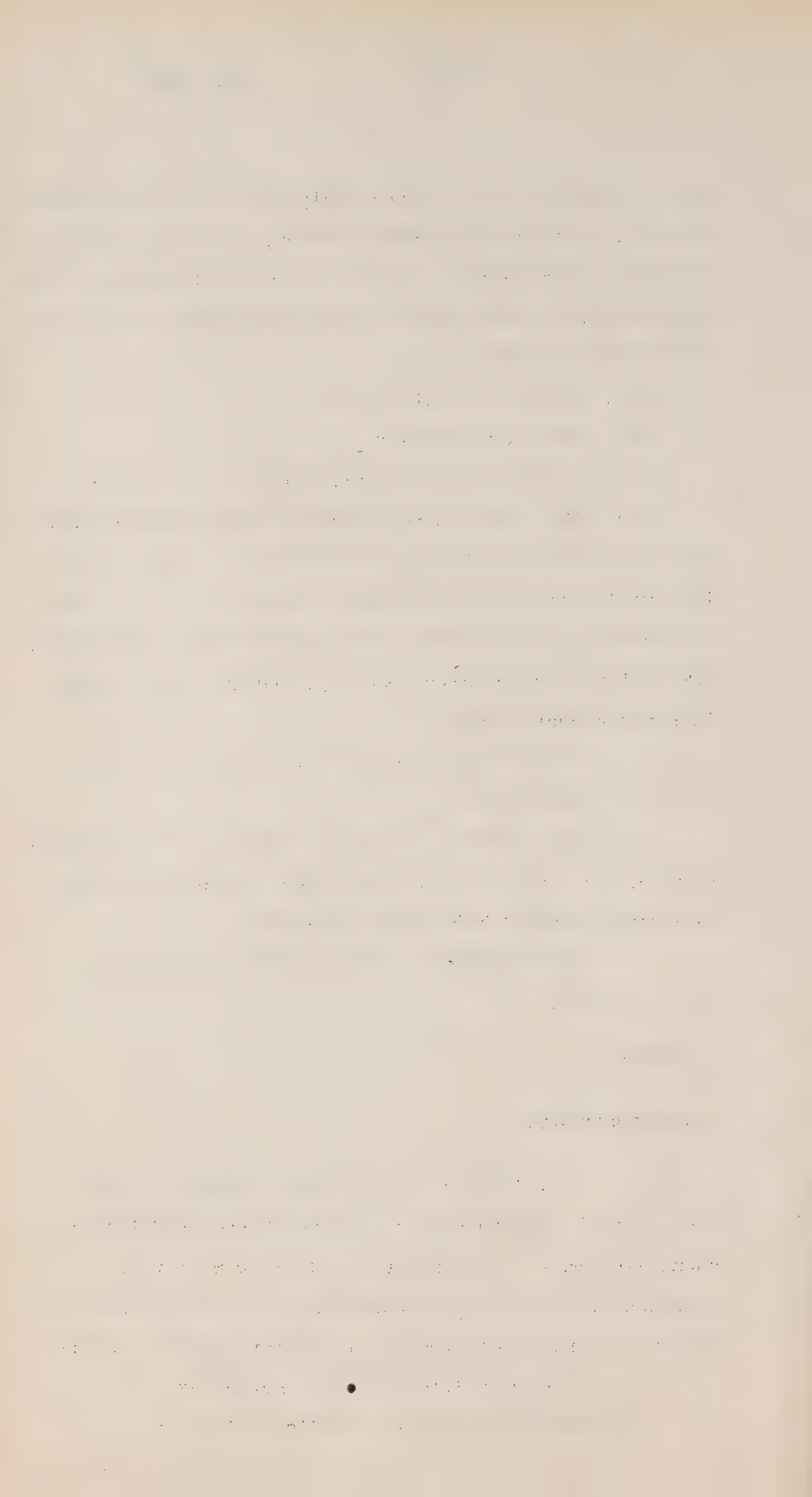
THE CHAIRMAN: Well, I think we had better take a recess.

---RECESS

---UPON RESUMING

MR. COVERT: Q. Now, Mr. Cooper, I would like to refer you to page 115 of the Canadian National submission where I think you are dealing with this question of depreciation accounting for roadway property, and at the end of paragraph (c) on that page you say:-

"The Canadian National, not being concerned with similar considerations in Canada, has seen no reason to take like action".



Now, you are referring there to the business of the increase in corporation and excess profit taxes which followed the outbreak of the war, as one of the things that led up to depreciation accounting on roadway property; and I think you do suggest there that there is a difference in the case of a company that does pay income tax and one that doesn't.

A. Yes, I think so.

Q. And you go on in the next paragraph dealing with the question of the market value of railroad securities:-

"No doubt the market value of railroad securities generally is affected by the known accounting policies of the industry." and you feel that the Canadian National is an exception to the industry in general,:-

"....in that the value of its obligations rests upon the guarantee of Canada, and the balance sheet of the railway is of no consequence marketwise. The Canadian National is a state-owned enterprise and there are no outside stockholders interested in the market value of its shares."

which again points out, it would seem to me, that you are also of the opinion that the tax question is involved in the subject of depreciation accounting for roadway property?

A. I agree.

Q. Now, I just wanted to ask you, I think it is a fair statement to say that you don't think much of the user method?

A. I gave three good reasons in its favour; I gave all the reasons in its favour. I did not make a





prejudiced statement.

Q. No, I am not suggesting that.

A. No, but in fine I am very strongly opposed to it.

Q. Yes, and you also mentioned the opinions of some people that you have discussed the matter with in the Interstate Commerce Commission.

A. They were the highest people.

Q. Yes, and I suppose that it is fair to say that one of their reasons would be that they have five hundred railways?

A. Well, that is not quite the way I would put it. I would say that their reasons, one of the reasons would be the difficulty they saw in controlling it.

Q. Yes.

A. And that difficulty might be on account of the large number of corporations which they would have to deal with.

Q. Yes, and now, what I would like to find out was whether in your view there really would be difficulty in controlling the user method as far as Canada is concerned?

A. Yes, I think there would.

Q. You think there would be?

A. I do.

Q. And are there any particular reasons that you could give to us?

A. I have given the reasons.

Q. Those are the reasons? You set out the reasons and they contain all your reasons right there?

A. Yes, sir. Plus the reason of course that so far



in Canada we do not have that same expert controlling body. No doubt we could build it up, but it will need building up.

Q. You are referring now to the Board of Transport Commissioners?

A. Yes, sir.

Q. In that connection perhaps I might deal with that point right now. In your opinion should the Board of Transport Commissioners be built up so that it could act as a capable referee between the railways and the public.

A. If they have to have uniform accounting and they are to see that uniform accounting is enforced, there will be no choice but for them to build it up.

Q. Yes, and that would involve in your opinion having a very capable accounting staff?

A. Yes.

Q. And an engineering staff, would that have to go hand in hand with it?

A. It should.

Q. Then I also wanted to ask you this with respect to that. You adopted depreciation accounting, I think, on rolling stock in 1942, was it?

A. 1940.

Q. 1940. Then in 194--

A. 1941?

Q. No, 1943. Mr. Cooper, at page 8 of your annual report, I noticed this:-

"The amount charged for depreciation on locomotives, freight and passenger, etc.

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was \$19,829,000 or approximately \$7.5 million more than would be provided for under average traffic conditions".

Then in 1944 on page 7 the annual report said:-

"The amount charged for depreciation on rolling stock was \$19,853,000 or approximately \$7 million more than would be provided for under average traffic conditions."

I just wanted to ask you whether that was not an indication that the Canadian National was practically on a user basis?

A. No, sir, you are under a misunderstanding.

Q. Let us correct it then.

A. The reason for keeping up those additional amounts in these war years was for three reasons. We began depreciation accounting in 1940. We started from scratch; we had no reserves at that time. I would estimate that the past accrued depreciation of our equipment existing at that date was in the order of \$175 million. The Canadian Pacific I believe have had an opportunity in ways which we did not have, of building up their reserves. We thought that during the war when our gross revenues and net revenues were so buoyant that we might take something extra out of our expenses and build up this reserve which, as I said, started from scratch.

The other reason was that when we started depreciation accounting we started with a very low rate. We started with 2.6%. One of the reasons why I went to Washington was to put the situation before the Commission





experts to ask them whether under the special considerations which we were facing, they thought a 2.6 rate would qualify as being depreciation accounting.

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(Page 18765 follows)



Well, they told us that it was just about the border line, that anything less than that would be more an appearance of depreciation without being depreciation accounting in fact. We were conscious then that our rate of 2.6 which ran from 1940 for the first five years was too low. You have to make a start on these things. When I put this thing up to the directors in 1940 I had to tell them that it meant a sizeable increase in their expenses, and I had to scale the charge down to the point which I thought would reach acceptance by the Board, but nevertheless we knew that our rate was too low, and so, as I say, in the war years we built up beyond the amount computed at the 2 per cent rate by these lump sum appropriations that you have referred to. We did not change our thinking, we did not change our practice. We still computed our depreciation on the straight-line method, but we took \$5 million here, we took \$7 million there; in all we took \$21.5 million out of our revenues to build up a reserve which started from January 1, 1940. If you will refer to that book which I have filed as an exhibit you will find exactly what we did, but they do not call it user method, they call it percentage revenue method. You will find that the method we used in those war years is described in that book.

Q. When I said you were really on the user method, Mr. Cooper, I did not mean that you were using the same method as the C.P.R., but I thought that perhaps the wording suggested that it was due to the traffic conditions having changed, and I think I will read you the wording again: "More than would be provided under average conditions", which would perhaps indicate that due to too much heavy use you were increasing your depreciation. Then I wanted to refer you also to 1945, where it says that equipment charges amounted to \$16,974,000, compared with \$19,853,000 in 1944,



the reduction resulting from the adoption in 1945 of a depreciation rate of 3-1/3 per cent, which is the average of the rates used by United States Class I roads.

A. That is what that statement says, yes. I do not think, though, that there is any justification for assuming that we recognized the user method of depreciation.

Q. What I meant really, Mr. Cooper, was that it seemed from these two annual reports that you recognized that the depreciation should be increased by quite substantial amounts because there was a much heavier traffic.

A. Well, the reasons really were the two that I have given you -- that we had no reserve to start with, and that our rate was too low.

Q. Those are a little different from the statement in the annual report.

A. Well, it often happens.

Q. I see. Then to go on with the question of the depreciation and the uniform accounting: As I understand the situation, your views and those of the Canadian National are that the Board of Transport Commissioners should be the body that would lay down the rules?

A. Yes, sir.

Q. They should also be the body that would lay down what property is to be subject to those rules?

A. I think so.

Q. And they would determine the rates?

A. I think so.

Q. Then what you say is that as far as the Canadian National is concerned you are prepared to take your chances before that Board?

A. Exactly.

Q. And you would urge the straight-line method as far as equipment is concerned?





A. Yes.

Q. And you would urge that there would be no depreciation accounting for roadway?

A. That would be our contention, and I think that those arguments should be presented to the Board.

Q. And they should be the ones that would decide?

A. I agree.

Q. Now, do you think that some consideration should be given perhaps to the different position of the Canadian Pacific as a privately-owned enterprise and their tax position in such matters?

A. You mean by the Board?

A. Yes?

A. I would not think so.

Q. You would not think so?

A. It may well be that after all these things are done we will be a taxpayer too.

Q. Yes. I do want to deal with that, in view of what you said, but perhaps I should clean up this matter first. Now, I think you did agree, Mr. Cooper, that one of the important things as far as comparability is concerned is to see that both do have to depreciate the same property; without that there cannot be proper comparison?

A. That is my view, yes.

Q. Now, I think, Mr. Cooper, that you are in favour of a consolidated report?

A. Yes, sir, I am.

Q. Could you explain in your opinion what the merits of this are in so far as the regulatory body is concerned over individual corporate reports?

A. Our views on that, Mr. Covert, are set out in our brief.

Q. I had in mind that perhaps they were dealing more



with the position of the Canadian National, in view of the fact that you really overlook---

MR O'DONNELL: Page 90.

MR COVERT: Q. You really pay no attention to the individual corporations which make up the Canadian National System?

A. We pay a lot of attention to them, because we have to put them together as if there were only one corporation. The fact that we have 85 corporations is a real difficulty with us. But since 1923 we have presented the affairs of the National System as if all the corporations had been consolidated by some legal process and that there was only the one corporation.

Q. That is what I meant, Mr. Cooper.

A. I would like to make a correction on page 90 of our main submission. At the top of the page, item number 3, it reads;

"Canadian Pacific recognizes the separate identity of its subsidiary telegraph company."

I have since learned that they do not have a company; it is a department of the Canadian Pacific Railway Company. I think that correction should be made.

THE CHAIRMAN: I am sorry, but I was looking for something while you were talking. It is this item 3 on page 90 that you are referring to?

A. Yes, sir, in the second section of that, where we say:

"Canadian Pacific recognizes the separate identity of its subsidiary telegraph company."

Q. You wish to correct that, do you?

A. Yes, sir.

Q. What should it be? What is the correction to be made?

MR COVERT: Q. They do not recognize---



A. Well, no. Perhaps the correction should be that--

THE CHAIRMAN: Or should it all be struck out?

MR EVANS: I do not think anything turns on it. I would not quarrel with an error of that kind. It has no significance really. The undoubted fact is that the communications department of the Canadian Pacific is a department and not a separate company.

MR O'DONNELL: That is correct, Mr. Liddy mentioned that, and when he mentioned it I drew it to Mr. Cooper's attention. Mr. Liddy on March 3rd, volume 88, said, "It is merely a department of the company."

MR EVANS: Perhaps if you wanted to have the thing correctly, we recognize the separate activity of that department.

THE CHAIRMAN: Then what is the difference between you? The item says Canadian National treats telegraph operations on a departmental basis.

MR COVERT: That is telegraph; but it is the next one.

THE CHAIRMAN: If the Canadian Pacific also deals with it on a departmental basis, what is the difference between you?

MR EVANS: Well, there is a very great difference, I think. They treat it as a department of the railway, do they not, Mr. Cooper?

THE WITNESS: Yes, sir.

MR EVANS: You treat your telegraph as a department of the railway?

THE WITNESS: Yes, sir.

MR EVANS: We treat it as a separate enterprise, although not separately incorporated.

MR O'DONNELL: Just a matter of words.

MR COVERT: Q. Mr. Cooper, what I was discussing





was your views as to the merits---

THE CHAIRMAN: Pardon me a moment. So there is no Canadian Pacific Telegraph Company?

MR EVANS: No, sir.

MR COVERT: Q. Your views, Mr. Cooper, as to the relative advantages if any of consolidated reporting as distinct from individual corporate reports, from the point of view of the regulatory body?

A. They are set out on page 90, continuing to page 96.

Q. And you say that the reasons set out there apply with equal force for any company, regardless of whether or not it operates as yours does?

A. Any company which has an organization such as ours, with eighty-odd different companies, in my opinion could not state its accounts in a satisfactory method, other than on a consolidated basis. Now, I am not saying that the Canadian Pacific cannot or anything else; I am saying that a company such as ours could not do it satisfactorily on any other basis.

Q. You go on, for instance, on page 93 to say;

"The I.C.C. issued an Order on December 18, 1941 requiring consolidated statistical statements in certain cases. On account of war conditions the filing of such statements was later waived and has not yet been resumed and the matter is now under consideration."

A. Yes.

Q. Then you go on to say that consolidated statements are recognized by the U. S. Securities & Exchange Commission, and so on?

A. Yes.

Q. Are you making a recommendation that all railways should file consolidated returns, or are you simply just-



ifying the position taken by the Canadian National?

A. I am justifying the position taken by the Canadian National.

Q. You are not suggesting that consolidated returns are essential or that they would be helpful to the Board of Transport Commissioners?

A. I am saying that they are essential so far as our company is concerned.

Q. Well, it seemed to me, when I asked you ~~this~~ question, that you were dealing entirely with your own, and what I had asked you was whether or not you were in favour of consolidated reporting generally, whether there are any advantages to the Board of Transport Commissioners. There had been no suggestion, apparently, that consolidated accounts were desirable or not desirable, at least as far as I know, until I saw your brief, and I just wondered if it meant that that should be part of the---

A. Would you go back to the previous page?

Q. Yes.

A. I am reading now the bottom paragraph there. I was trying to point out the important differences in the accounting between the two railways so far as I know those difficulties. I said:

"It is in the matter of their published annual reports that the main differences in the accounting policies of the two railways appear. These are reports from the Boards of Directors to the shareholders of the two railways and they are not subject to control by regulatory authority."

So I think it is---

THE CHAIRMAN: Are you reading there from the brief?

A. Yes, sir.



THE CHAIRMAN: Where is it?

MR COVERT: Page 89, the last paragraph on the page, my lord.

THE WITNESS: I am making it clear there, you see, that they are not in any way suggesting that things of this kind should be regulated or made uniform. I go on to explain what are the principal differences, and I say:

"In so far as can be ascertained by Canadian National the principal differences in the accounts of the two railways as they appear in their published annual reports are as follows:

1. Canadian National accounts are published on a consolidated basis.

Canadian Pacific accounts are those of a parent company."

And then over on page 90 I explain why ours are on a consolidated basis, but I do not make any suggestion that the Canadian Pacific should be on a consolidated basis. That is a matter that the Board, I take it, would have to consider and decide.

MR COVERT: Q. Now, what I want to find out, Mr. Cooper, is whether or not uniformity of accounts should also prescribe consolidated reporting, in your view?

A. I would say not. I think consolidated statements are something in addition to the accounts to be prescribed in account classifications.

Q. Then in your view would I say this, Mr. Cooper, that to bring about the desired uniformity of accounts, which has been something which we perhaps could conclude from the unanimity of all is something devoutly to be desired, you say consolidated reporting is not necessary?

A. Not to be a matter for inclusion in accounting classifications to be prescribed by the Board.

Q. I do not know, Mr. Cooper, whether that gives me





all the information I want. Let us say that that is one answer. Now, is there another answer, that the regulatory board should be furnished with consolidated returns?

A. I did furnish -- it is referred to at the foot of page 92 -- a publication by the Interstate Commerce Commission---

Q. That is right; that was filed this morning as an exhibit, I think.

A. Yes. And my purpose in filing that exhibit was that whoever is considering this matter of uniform accounting would have available the study that the Interstate Commerce Commission made into that subject, and the conclusions which they reached, and I would believe that that---

THE CHAIRMAN: Q. What was their net conclusion?

A. I think, sir, that they say you should---

Q. Do they prescribe uniform accounting?

A. No, sir, but they are going to require -- at least, my information is to that effect, that they are going to insist on the carriers furnishing consolidated statements in certain cases.

MR COVERT: Q. That is the point that I am trying to arrive at, Mr. Cooper, what your views are on that. I am asking this for the benefit of the Commission: Is it in your view necessary to have consolidated reporting in Canada?

A. It is necessary so far as the Canadian National Railway is concerned, yes. I do not know enough about the affairs of the Canadian Pacific Railway Company to say whether their reports on their present company basis are satisfactory or not.

Q. Then can I put it this way: Are you suggesting that the Board of Transport Commissioners should investi-



gate this matter as one of the items involved under uniform accounting?

A. Yes.

Q. That is as far as you want to go?

A. That is right.

COMMISSIONER INNIS: Q. On page 89 you have something to say about the Dominion Bureau of Statistics, to the effect that on a few known particulars there was apparently disagreement; are those particulars at all serious?

A. It is again a question of degree. I do not know how serious these things are. Take the case of the Canadian National Express and the Canadian Pacific Express. We have two methods. The Canadian National treat express operations as if it was straight rail line operation. We do not see any distinction between express and say milk traffic or mail traffic, so we treat our express department in the same way we treat passenger and freight and other rail transportation business. It is my understanding that the Canadian Pacific do not do that. They operate a separate express company, and the express company transfers to the railway company its what are termed express privileges, which is a kind of payment for rent for the facilities provided by the railway. The amount so transferred is taken into the Canadian Pacific accounts in their rail line revenues. So that we have the gross revenues in our gross revenues and our express expenses in our rail line expenses, whereas the Canadian Pacific take a net figure into railway operating revenues. The effect on net revenue is substantially the same, but it does affect the operating ratio as to whether they are taken in on a gross basis or they are taken in on a net basis. On a comparison of operating ratios between the two companies



the different method shows up unfavourably as to the Canadian National Railway.

MR COVERT: Q. On matters of this kind, Mr. Cooper, I take it that the Canadian National's position is that the question as to how these are to be dealt with should be a matter for the Board of Transport Commissioners?

A. I do.

Q. And you are prepared to abide by the decision they make?

A. Yes, sir. If we have not a case we will be knocked down, and we will take it.

THE CHAIRMAN: Are you about through?

MR COVERT: Well, no. I might just ask this one question, Mr. Chairman.

Q. I was just wondering if the Canadian National had made any estimates of what they had lost in revenue because of what might be termed delays in the decisions in the rate cases; have you made any estimates of that?

A. Would that be the amount of revenue which would have been earned if say instead of October 11th---

Q. Yes.

A. ---the increases had been put into effect as of some fixed date?

Q. Yes.

A. No, I have not made that.

Q. You have not?

A. No.

MR O'DONNELL: We would have to have a fixed date in each case. We would have to have a cut-off date in each case as to which to make the computation.

THE CHAIRMAN: There is reference made in some of the figures furnished as to what---

MR O'DONNELL: Yes. We said that the imbalance





between operating expenses and the increases was some \$79 million; but I think to make the computation my friend asked for we would have to have a cut-off date. We would have to assume that say the day after we made the application we would get the increase, or we would get the increase a month after we made the application.

MR COVERT: My suggestion was going to be that you would take a month after the application was made.

MR O'DONNELL: That is fair enough.

MR COVERT: And I wonder if we could have that.

THE WITNESS: I think the Chairman was correct in saying that something, some information on that---

THE CHAIRMAN: Yes, you did give us figures there to show what would have occurred if you had had these revenues over the whole of the year instead of from the 11th of October on.

THE WITNESS: Yes. For example, we said this morning that if the 8 per cent freight rate increase had been in effect from January 1, 1949, instead of from October 11, it would have increased our revenues by \$12,056,000. Now, you could easily work that back to any date you like.

MR O'DONNELL: Mr. Covert would like you to do it, I think, Mr. Cooper, and he suggests that we make the computation on the basis that one month from the date of each application the award would have come into force.

THE WITNESS: Yes.

THE CHAIRMAN: Then we will take that up in the morning.

---The Commission adjourned at 4:47 p.m., to meet again at 10:30 a.m., on Wednesday, March 22, 1950.



A.A.

*Amesbury*

ROYAL COMMISSION  
ON  
TRANSPORTATION

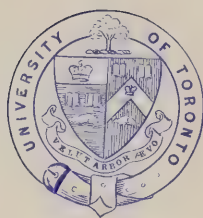
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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, Wednesday,  
March 22, 1950.  
Index Page #122

<u>EXHIBIT No.250:</u>	Filed by	Canadian National	<u>Page</u>
	Mr. O'Donnell:	Railways - statement as to Estimated Re- venue Accruing had Rate Increases be- come effective one month subsequent to date of application	18778
<u>EXHIBIT No.251:</u>	Filed by	Statement showing Re-	
	Mr.O'Donnell:	sults of Operation on Restated Basis, 1939 - 1948 - - -	18778
<u>T. H. COOPER RECALLED.</u>	Examination by Mr.Covert	resumed - - - - -	18778
Noon adjournment - - - - -			18843
Mr.Covert:	Request to C.P.R. for	exhibit similar to Exhibit 250	
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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO  
WEDNESDAY  
MARCH 22, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN  
HAROLD ADAMS INNIS - COMMISSIONER  
HENRY FORBES ANGUS - COMMISSIONER

-----  
G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary  
-----

COUNSEL APPEARING:-

F.M. Covert, K.C.	}	Royal Commission on Transportation
G.C. Desmarais, K.C.		
H.E. O'Donnell, K.C.	}	Canadian National Railways
N.J. MacMillan		
H.C. Friel, K.C.		
C.F.H. Carson, K.C.	}	Canadian Pacific Railway
F.C.S. Evans, K.C.		
I.D. Sinclair		
C.D. Shepard	)	Province of Manitoba
M.A. MacPherson, K.C.	)	Province of Saskatchewan
J.J. Frawley, K.C.	)	Province of Alberta
F.D. Smith, K.C.	}	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade.

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- 18776 -

Ottawa, Ontario,  
Wednesday, March 22, 1950.

MORNING SESSION

MR O'DONNELL: May it please the Commission, Mr Covert asked Mr. Cooper yesterday if he could prepare a statement showing what the estimate of revenue accruing would be had the rate increase becoming effective one month subsequent to the date of the application. I have here a statement which might be produced as --

MR. COVERT: Exhibit 250.

MR O'DONNELL: -- Exhibit 250. Mr. Covert also asked Mr. Cooper to prepare a statement as to the results of operations on a re-stated basis. Mr. Cooper has another statement which I produce as Exhibit 251.

THE CHAIRMAN: What do you say it is? What is the point?

MR O'DONNELL: It is showing the results of operations on a re-stated basis, 1939 to 1948 had the interest receivable on the Government capital fund of \$300 million been available; that is, that there would be \$9 million a year interest and so on. Those are the figures that Mr. Covert asked him to re-state, and that is Exhibit 251.

THE CHAIRMAN: You have copies of those exhibits, have you?

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: Could we have those?

MR O'DONNELL: Yes, my lord. I should like to make it very clear, inasmuch as it has been indicated to me by one of my friends that this Exhibit 250 was asked for by Commission Counsel, that it was in compliance with that request that it is being put forward.

THE CHAIRMAN: Yes, it shows what the figure

EXHIBIT 22

It is the policy of the Commission  
to make every effort to make the public  
understand the Commission's position  
on the various matters which are  
presented to it. It is the policy  
of the Commission to make every effort  
to make the public understand the  
Commission's position on the various  
matters which are presented to it.

MR. CHAIRMAN: Exhibit 22.

MR. CHAIRMAN: Exhibit 22. It is the  
policy of the Commission to make every  
effort to make the public understand  
the Commission's position on the  
various matters which are presented  
to it.

MR. CHAIRMAN: What do you say to that?

Yes, sir.

MR. CHAIRMAN: It is the policy of the Commission

to make every effort to make the public

understand the Commission's position on the

various matters which are presented to it.

It is the policy of the Commission to make every

effort to make the public understand the

Yes, sir.

MR. CHAIRMAN: You say you are not going to

Yes, sir.

MR. CHAIRMAN: Yes, sir.

MR. CHAIRMAN: Could we have the

MR. CHAIRMAN: Yes, sir.

It is very important to make every effort

to make the public understand the Commission's

position on the various matters which are

presented to it. It is the policy of the

MR. CHAIRMAN: Yes, it shows what the

might have been. What is the difference between the two figures?

MR. O'DONNELL: What additional revenue there would be had the increase which was applied for on the date mentioned in the Exhibit been granted within one month of the making of the application in each case.

THE CHAIRMAN: Does this show the additional or the total as it would have been including the actual ?

MR. O'DONNELL: Q. That would be the additional, would it not, Mr. Cooper?

MR. COOPER: Yes.

THE CHAIRMAN: The additional only?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Approximately \$100 million.

MR. O'DONNELL: \$109,748,000.

MR. COVERT: My reason for asking for it, Mr. Chairman, was that there had been suggestions that one of the unfortunate things about the rate cases was the delay.

THE CHAIRMAN: Yes; that is a pertinent matter.

MR. O'DONNELL: We had no objection to giving it.

MR. FRAWLEY: That being so, may I say that it is quite all right for my friend Mr. Covert to want to put this evidence on the record. But speaking for myself I should like to say that we apologize in no manner for the fact that the rate cases took as long as they did. There are many factors that entered into the situation which explain and justify the time that was taken. For months and months we were groping and groping because of the manner in which the railways



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presented their case, and of course it took a long time. We demanded particulars, and we got some; others we did not get. I submit with respect that there must be no implications left in the minds of this Commission that we the Provinces are responsible for losing this amount of money to the Canadian National Railways.

COMMISSIONER ANGUS: Are you equally anxious to avoid similar delays in future cases?

MR. FRAWLEY: I think the railways have now learned a good deal as to how to present their case.

MR. CARSON: I take it that Mr. Frawley is saying that he is perfectly blameless.

MR. FRAWLEY: Yes, indeed.

...EXHIBIT 250.....filed by	:	Canadian National
Mr. O'Donnell	:	Railways - - state-
	:	ment as to Estimated
	:	Revenue Accruing had
	:	Rate Increases become
	:	Effective One Month
	:	Subsequent to Date of
	:	Application.

...EXHIBIT 251.....filed by	:	Statement showing
Mr. O'Donnell	:	Results of Operation
	:	on Restated Basis,
	:	1939 - 1948.

T. H. COOPER RECALLED

EXAMINATION BY MR. COVERT - (Cont.)

THE WITNESS: Mr. Covert, may I interrupt for one moment with respect to Exhibit 251.

Q. All right, Mr. Cooper.

A. I have prepared this statement at your request and it is prepared as I understood you wished to have it. But in submitting it, I do not want it to appear that this



is an Exhibit produced by the Canadian National Railways, except to meet your request. I should like to add all the protests which I made yesterday afternoon to the use of the figures in this way.

Q. As I understand it, your objection is this. You say it is not realistic?

A. Yes.

Q. Because you say that this \$9 million should not have been taken into consideration in 1939. I think you said that that should not be taken back in 1949?

A. That is one consideration.

THE CHAIRMAN: Q. Mr. Cooper, this remark of yours applies only to Exhibit 251?

A. Yes.

(Page 18780 follows)



MR COVERT: With respect to Exhibit 251 there is one thing I have just seen, my lord, and I just want to get an understanding of it. Q. Mr. Cooper, you have taken operating revenues, deducted operating expenses, leaving you a net operating revenue?

A. Yes.

Q. From that you have deducted taxes, equipment, rents and Other Income, leaving the amount available for payment of interest?

A. Yes.

Q. Now, is that interest on the funded debt ?

A. Yes.

Q. Then the next figure is the interest on bonds held by the public?

A. Yes.

Q. That is, the bonds that were held in each of those years?

A. Yes.

Q. That were actually outstanding?

A. This is the interest which we paid on the debts held by the public in each of those years.

Q. Oh, yes. I am sorry, there was apparently a misunderstanding. What I had wanted you to take into consideration there was to re-cast that giving effect to the revision of the capital structure as if it had taken place.

A. That is what I have done, Mr. Covert.

Q. Oh, have you?

A. Yes, I have dropped from the results of these years the interest on the Government loans and then I have taken a credit for the \$9 million, and I have reduced our interest payments by the \$9 million, to produce the





interest payments which would have been made if interest on Government loans had been cancelled and we had been receiving the three percent on the capital fund of \$300 million in each of the nine years.

Q. Yes, again perhaps we have misunderstood each other. What I had intended was this, that you would take a position in 1939 as if the proposals which you now suggest had been given effect to; in other words it would have reduced your interest requirements by \$21.8 million.

A. That is what I have done, Mr. Covert.

Q. Oh, have you?

A. Yes.

Q. Then you have assumed for the purposes of 1939 for example that the bonds held by the public were only \$584 million, is it?

A. No, in 1939 our fixed charges were -- let me speak of 1948  $\frac{1}{2}$  if I may, because the figures are more---

Q. Yes, I am sorry?

A. Our fixed charges in 1948 as shown on Exhibit no. -I don't know what the number is.

MR O'DONNELL: 251.

THE WITNESS: Exhibit 251 were \$46,341,727. That included , \$23,202,817 of interest on the funded debt held by the public. Now, that is a figure which I have shown in the end column as interest on bonds held by the public.

Q. Yes?

A. The figure of \$46,341,727 which I referred to a moment ago as being our fixed charges, included \$21,627,032 of Government interest. Now, in Exhibit 251 I have eliminated that item of interest, and in addition I have taken credit for \$9 million which is precisely what



is proposed or what has been proposed by the President in his submission to the Commission.

Q. Well, as long as we are clear. Can you look at the figures for 1939 on Exhibits 251?

A. Yes.

Q. That is 251, the one you have filed this morning

A. Yes.

Q. Now, what were the interest requirements on bonds held by the public in 1939?

A. The figure was \$49,814,378.

Q. Yes. Now, what was the amount of outstanding bonds held by the public?

A. \$1,263,401,000.

Q. That is, held by the public?

A. Yes.

Q. That is where we have reached a misunderstanding, Mr. Cooper. You see, what you have done is you have taken out of each year only the interest on bonds then held by the public; but what I asked you to assume was, if the submission of the President had been put into effect in 1939, not just that the bonds as they exist today, the funded debt held by the Government as it exists today, or taking into consideration the bonds held by the public today; but giving you the full relief that you have now asked for, that is, if there had been left on the books of the C.N.R. a funded debt of only \$584 million, what would have been your position?

A. Yes, I follow that. I might mention or remind you that I said, when you asked me, that I would check with you before we went to work on the statement, and I showed you a sample of what I proposed to do, and you told me it was satisfactory.



Q. Well then, if that is so, I certainly misunderstood it because what I wanted you to do was to recast the position back to 1939 ..

A. Yes, well, we will make a further statement.

Q. I am very sorry about that, Mr. Cooper, because apparently it is my fault.

A. Yes, we will prepare another statement, but the further statement is going to be even more unrealistic than this one.

MR O'DONNELL: You would like the unrealistic further statement?

MR COVERT: The unrealistic further statement.

MR O'DONNELL: Right.

MR COVERT: Q. Now, Mr Cooper, yesterday you stated that as far as the C.N.R. was concerned, you were willing to be made subject to income tax, and you say:

"If you adjust our capital structure, put us on a parity with the Canadian Pacific in respect of those matters, we are satisfied to be put on a parity with them with respect to matters such as income taxes."

Now, what I wanted to do, if I could, was to see if it were possible to put the two companies on a parity. Now, you put them on a parity with respect to proportion or ratio of funded debt, that is your suggestion here. Then you say you are willing to pay income taxes too. Now, do you think that that would put the two roads on a parity if you adjust those two things?

A. I think you have taken my statement there just a shade too literally. I was speaking in broad terms. I was saying, or I intended to say, that if we were put on a parity, as has been proposed, that there would be no





objection on our part to our being made liable for Canadian income tax. I did not mean that we should have precisely the same percentage of funded debt and precisely the same percentage of equity capital.

Q. No.

A. I was speaking in a broad way as if the proposals which had been submitted which are intended to put us broadly on a comparative basis, had been made effective. Then I said: we will also be on a parity with our competitor in the matter of income tax.

Q. Yes. Well now, would these proposals put you on a parity with the C.P.R.?

A. Oh, I think we would be very inferior yet to the Canadian Pacific. I showed you yesterday that for the year 1949 with all the additional revenues assumed to have been received, with these adjustments made, that our net income would be a matter of \$13 million. Now, that surplus would disappear if our traffic volume were to be reduced by  $2\frac{1}{2}$  per cent. I said therefore that even on this basis there is really nothing left for a return on equity capital, there is nothing left for additions and betterments. I don't think on that basis that we have yet approached comparability with the Canadian Pacific, in results.

Q. Now, Mr. Cooper, that is just taking 1949, but what I wanted to do was to work out with you, if I could, some broad principles. If you reduce the funded debt of the Canadian National to approximately \$580 million, and then you have this \$300 million indebtedness from the Government, it in effect reduces your capital charges to about \$14 million, doesn't it?

A. Our interest charges on the revised basis



for the year 1948 would be \$23,202,817, less \$9 million \$14,202,817.

Q. Yes, could we compare that with something in Canadian Pacific for instance?

A. I believe the Canadian Pacific fixed charges were in 1948 \$15,890,264. Now, those figures are not comparable. I was giving you the interest on funded debt in the case of Canadian National whereas I have quoted fixed charges in the case of Canadian Pacific. I would have to take out of the \$15,890,264 of fixed charges for the Canadian Pacific those items which are not interest payments, and I have not that breakdown here.

Q. Well, could you add something to your \$14.202 million of the Canadian National to bring it up to the---

(Page 18787 follows)



A. The Canadian National fixed charges for 1948 as reduced would be \$15,714,695, and the Canadian Pacific would be \$15,890,264.

Q. So they would be, then, about the same?

A. In figures, yes.

Q. Now, what I am trying to find out, Mr. Cooper, is how else we could put them, as I say, on a comparable basis. Now, to live, for example, I suppose the Canadian Pacific must pay their preference dividends -- that is, to live for any length of time?

A. I think they have been known not to pay it.

Q. Yes, but, as I say, to live for any length of time wouldn't you regard that as being so, bearing in mind that one is privately-owned and one is publicly-owned? What I wanted to find out was, if there are certain things that the Canadian Pacific must pay to live, as compared with what the Canadian National must pay to live. I think you said yesterday that the fact that the state guarantees your interest, and I think you mentioned in one case that there was -- not in particular the Canadian National, but dealing with a predecessor, that there was no question of bankruptcy of a Government-owned railway. Now, I say, bearing that in mind, what I wanted to find out was what amounts you would say that both of them have to earn to continue. Now, do you think that is possible? I was going to suggest to you that they should perhaps pay a preference dividend of 4 and a common dividend of 5, or that they should have to pay income tax and have something for surplus. What I want to find out is what you say the Canadian National must do to put them on this so-called comparable basis?

A. I think it would be highly desirable that the Canadian Pacific should continue to pay dividends on its





common and preference shares, and certainly from my point of view I would hope that that position will never be jeopardized. What the Canadian National should have as a comparable position would mean that in addition to the interest on our fixed debt we should pay a return on the equity capital, and we have not taken any different position.

MR FRAWLEY: I did not catch the last part of the answer.

MR COVERT: He said, "We have not taken any different position."

Q. I prefaced this, Mr. Cooper, by saying to live, and by that I do not mean just to live tomorrow, but for a period of years. For instance, the Board of Transport Commissioners held, I think, in the 21% Case, that there should be \$15.7 million for fixed charges, \$21.3 million for preference and common dividends, income tax of \$9 million, and surplus of \$15.2, or \$61 million.

THE CHAIRMAN: Mr. Covert, are your questions addressed to what the company ought to do if it disregarded Government guarantees and still kept out of bankruptcy, what position it ought to be in? Is that the point?

MR COVERT: My point is this: References have been made to putting them on a comparable basis. Now, I am suggesting to the witness that to live and continue and carry on it would seem---

THE CHAIRMAN: Have you in mind that behind that they always have the Government and Government guarantees and so on?

MR COVERT: First I was directing it as far as the Canadian Pacific was concerned. To live and carry on it would seem that they must have to have somewhere in the vicinity of the figure of \$60 million.

THE CHAIRMAN: Quite.



MR COVERT: Now what I am trying to find out is what the Canadian National must have to live.

THE CHAIRMAN: Well, having regard to the fact that it is supported by the state---

MR COVERT: That is right, supported by the state.

THE CHAIRMAN: That is one thing.

MR COVERT: That is one thing.

THE CHAIRMAN: I thought perhaps you were trying to ascertain what it would have to have to live if it were not 'supported by the Government.

MR COVERT: I was coming to that, Mr. Chairman, but it seemed to me that we had to deal with this first.

THE CHAIRMAN: All right; I see.

MR COVERT: Q. Now, could we get down to some basis like that, Mr. Cooper?

A. I think that is rather an important question, which I would like to spend some time on. I would have no objection to taking it under consideration and perhaps coming back tomorrow with an answer to that question.

MR O'DONNELL: I think that is a very broad subject, and just to ask Mr. Cooper to do the mental gymnastics in the box is a little difficult. I think he would be glad to try to go into that, but certainly the money which the Canadian National requires before it reaches the point where it has a surplus is altogether different from the money which the Canadian Pacific requires before it reaches the point where it has a surplus. The matter of comparability is something that has to be approached from quite a number of different angles, and I think at this point we might ask that you be good enough to allow it to remain for consideration and study.

MR FRAWLEY: My lord, so that I can follow Mr. Covert's cross-examination, perhaps he would be good enough





to indicate again the figures he says the C.P.R. needs, and just how it was made up. I did not catch the explanation.

MR COVERT: I had taken the figures, Mr. Frawley, roughly, of fixed charges of 15.7, preference and common dividends of 21.3, surplus of 15.2, and income tax of 9 million.

MR SHEPARD: Mr. Chairman, I think perhaps some comment should be made, that as far as those figures are concerned, I know that my friend Mr. Covert is thoroughly familiar with what is going on now and what has been going on, but there has been a great deal of discussion as to whether those figures are in fact the financial needs of the C.P.R. The question of surplus is now under appeal to the Dominion Cabinet. The question of dividend and fixed charge requirements has been the subject of continued litigation, and the provinces have been contending that there should be an apportionment there.

MR COVERT: Well, my lord, that is the figure. I cannot take a figure and say it is correct and satisfy all parties.

THE CHAIRMAN: You have to take a figure subject to these objections.

MR COVERT: Q. Mr. Cooper, at the same time you might consider this: If there is to be comparability with respect to one, it would seem to me that you might have to consider the effect that it may have of making the two roads comparable as far as fixed charges are concerned, the effect that that will have on other phases of comparability. I think that that may be important, and I just ask you if you could to give us your opinion on that later.

A. Yes.

Q. Now, I wanted to take up with you, Mr. Cooper, this





question. Mr. Gordon indicated that the past could not be taken as an indication of what to expect in the future, and I think you have said the same thing in your evidence -- I could find the specific page if you needed it, but I think you will recall it -- that there had to be a relation between the capital structure and the future earnings of the company. Now, it would seem to me that that was very important, and I just wanted to know if there is any basis which you could suggest of forecasting or making an estimate of what you would consider normal earnings for the Canadian National -- that is, assuming a reasonable level of rates and tolls, because your statements have been predicated on the fact that there is an imbalance due to the lack of proper rates and tolls?

A. How far into the future do you wish me to look?

Q. Well, Mr. Cooper, I cannot tell you that. I am saying just that you and Mr. Gordon both have used the expression yourselves. Now, that is why I am asking you. I do not know how far in the future either of you did look.

THE CHAIRMAN: I did not catch Mr. Cooper's objection.

Q. What was it you said?

A. I was asking Mr. Covert how far he wished me to project my thinking into the future. He said could I make an estimate of the financial needs of the system looking forward, and "forward" is a very indefinite period. If you want five years or ten years, it is a vastly different thing. We find quite a difficulty in submitting a budget for the year 1950. For example, we have prepared a budget for the year 1950, and it has already been thrown out of balance by the additional freight increase which was recently granted by the Board and which goes into effect this week. Our budget for 1950, which was prepared about three weeks ago, is already out by



\$15 million on that one item.

MR COVERT: Q. Mr. Cooper, all I am saying is that when you say that a realistic capitalization of the Canadian National must of necessity be related to its future earning power, then you say you really cannot do it?

A. I said yesterday, I think, Mr. Covert, that that was rather to emphasize that the adjustment which was proposed should not be based solely on the past earning power of the company. It could have been expressed negatively rather than the way it was; we could have said that in arriving at this adjustment you must not take our record as it stands and come to any conclusions on that.

Q. Now, Mr. Cooper, perhaps we could deal with that a bit. I think that you took a figure -- that is on page 18639, in volume 99, just about in the middle of the page -- you said this:

"In the 26 year period 1923 to 1948 the net earnings of the System available for the payment of interest averaged \$27,660,483 per annum, which, when capitalized (3.39%), equals \$816 millions."

Now, if you capitalized it at your present rate I think it would equal somewhere around \$838 million. Then you go on and say:

"This amount of fixed charge debt cannot be used as a reasonable guide to the future without regard being given to changed conditions embracing increased costs of operation, including material prices" and so on. That was for a 26-year period, Mr. Cooper, and I am suggesting to you that it includes the period when you had taken over all of the lines and were in the process of co-ordinating them?

A. Yes.

Q. Now, how long would you say that that period lasted,



Mr. Cooper?

A. Approximately the first decade after amalgamation.

Q. And that was a period of heavy expenditures?

THE CHAIRMAN: Q. That period is beginning in 1923?

A. Yes, my lord. The expenditures we were speaking of -- I think the figure is \$100 million -- was more of a capital expenditure.

MR COVERT: Q. Yes, but wouldn't you say that during some of that period it was a period of more than just heavy capital expenditures? Didn't the Duff Commission indicate that?

A. Yes, I would agree that in the first ten years of operation our maintenance costs were charged to some extent with the backlog of maintenance which came over in 1923.

Q. It was also a period of the great depression?

A. Yes.

Q. That period of 26 years?

A. Yes.

Q. And then you had the boom period of the war?

A. Yes.

Q. But that period, war and post-war, you also had what you would call a period of low rates?

A. Well, we made very substantial net earnings during the war.

Q. Could we put it this far, Mr. Cooper: You would agree, I think, that from 1945 on you had a period of low rates?

A. Low rates relative to our costs, yes.

Q. So that by and large, when you take that 26-year period, there is a long period in there where the circumstances under which the Canadian National operates are most adverse -- a period of co-ordination, a period of depression, and a period of low rates relative to cost?





A. May I refer you, Mr. Covert---

MR O'DONNELL: Well, is that quite right? Low rates relative to cost -- you are referring to the last few years?

MR COVERT: Yes.

MR O'DONNELL: When the imbalance occurs.

MR COVERT: Yes.

MR O'DONNELL: The last four years.

MR COVERT: Oh, yes.

THE WITNESS: May I refer you, Mr. Covert, for an answer to your question, to Table No. 4A on page 37 of the main submission. That is a statement which was prepared to take out of the 26-year period the depression years and the war years, and on that assumption it shows that the average deficit would be \$20,899,806 per annum; and that figure compared with the figure on page 52, which includes all of the years, shows that, excluding the depression years and the war years, our deficit was somewhat greater than it was for the full period.

(Page 18797 follows)



Q. All I have asked you, Mr. Cooper, is this. During that period of twenty-six years, having regard to the Canadian National, you did have extreme adversities and you were operating under extreme conditions; that is, during the period of co-ordination and the period of depression and the post-war period, when the rates were, as you say, out of balance with your costs.

A. It is my opinion, on looking at the record of the Canadian National since amalgamation, taking the good years with the bad, we have averaged, as is shown on Exhibit 251, an average annual deficit of \$20.8 million.

MR. O'DONNELL: That is not Exhibit 251.

MR. COVERT: No, it is Exhibit 228.

THE WITNESS: I pointed out yesterday that some adjustments should be made to relate the past with the present, and I did not want to go into all the affairs which are different today than what they were over the twenty-six year period. I said there should be an adjustment with respect to depreciation accounting. We commenced depreciation accounting in 1940. We did not have it for the period 1923-1949. That is a major adjustment that should be made, so I made it. I think too, in looking at our present situation, that it is inescapable that one should make an adjustment with respect to the addition of the Newfoundland Railway to our Railway System. That is something that happened last year. There is nothing in the twenty-seven years of operation with respect to that. Taking those two adjustments together, I told you - -

Q. I know you did, Mr. Cooper; and with respect, I say that I do not think you are answering my question.

A. I am sorry. What is your question, please?



Q. I have asked you if, over that long period of twenty-six years, the Canadian National probably more than any other railway was not operating under extremely adverse conditions for the major part of the period?

A. I do not think I would agree with you on that.

Q. In connection with the same matter, would you not think that the tremendous increase in the population of the country today, as compared with what it was during the first half of that period, would also have a tremendous effect on the future of the Canadian National?

A. I agree with that, yes.

Q. And therefore, rather than say that you could take those twenty-six years as a test, would you not think that the future of the Canadian National is probably a great deal brighter than as represented by those twenty-six years?

A. I think you are overlooking the effect of competition from trucks, buses and airways; that competition is a very serious problem for the railways, looking into the future.

Q. In your view, Mr. Cooper, is that one of the most serious problems of the railway?

A. I should say yes; and Mr. Fairweather can go into that matter very thoroughly.

Q. But coming back to my question, I just wanted to find out whether or not you really think that this twenty-six year period is really not an unfavourable period as compared with the possible future of the Canadian National, and you say you cannot agree with that?

A. That is my opinion.

Q. In other words, you think that the years ahead



the first of the year.

The second of the year.

The third of the year.

The fourth of the year.

The fifth of the year.

The sixth of the year.

The seventh of the year.

The eighth of the year.

The ninth of the year.

The tenth of the year.

The eleventh of the year.

The twelfth of the year.

The thirteenth of the year.

The fourteenth of the year.

The fifteenth of the year.

The sixteenth of the year.

The seventeenth of the year.

The eighteenth of the year.

The nineteenth of the year.

The twentieth of the year.

The twenty-first of the year.

The twenty-second of the year.

The twenty-third of the year.

The twenty-fourth of the year.

The twenty-fifth of the year.

The twenty-sixth of the year.

The twenty-seventh of the year.

The twenty-eighth of the year.

The twenty-ninth of the year.

The thirtieth of the year.

The thirty-first of the year.

will not be, on the whole, as good as those past twenty-six years?

A. As things stand, 1950 will not be as good as 1949. For the first two months of this year, our traffic has fallen off by 8%.

Q. So your answer to that question I just put to you is that you do not think the next twenty-six years will be as good as the past twenty-six years?

MR. O'DONNELL: He did not say that.

THE WITNESS: I did not say that.

MR. COVERT: Q. I asked you - -

A. I am not going to forecast what I think will happen in Canada during the next twenty-six years.

MR. O'DONNELL: He had trouble looking ahead one year.

MR. COVERT: Q. Then in revising the capital structure of the Canadian National, in your view we really cannot take the results of the twenty-six years past as a guide?

A. Not and determine the adjustment on that by itself.

Q. And we cannot make an estimate of the future for that purpose?

A. I doubt it very much.

Q. Then in order to determine what should be the capital debt of the Canadian National, must we then fall back and compare it with other Class I roads?

A. I would say that is one of the yardsticks you should use.

Q. What would be another yardstick?

A. The determination of what would be a proper



capitalization for the Canadian National Railways is a matter which has been decided, as far as the railways are concerned, on the judgment of our President. I think Mr. Donald Gordon probably is as well qualified as any man in Canada to review the economic future of this country and to appraise correctly the situation of the Canadian National with respect to its ability to carry a reduced capitalization. The proposals which have been made represent his judgment. They are concurred in by his Board of Directors. I am not here to express my views. I am here to furnish factual information as far as that is needed to support the proposals which have been made.

Q. Yes, Mr. Cooper; but we must know the tests or the reasons which you use to arrive at a conclusion or a recommendation. You have given me one yardstick, and the other yardstick is Mr. Gordon's judgment. What I want to find out is if there is another yardstick we can examine.

A. You have the record of the past.

Q. But you have told me in effect that you cannot take that.

A. I say it is a factor.

Q. Let us take the comparison you make with the United States roads. As you are more familiar with your Brief than I am, Mr. Cooper, could you tell me the page at which this matter is dealt with?

A. At page 54, I think, Mr. Covert.

Q. You compare the fixed charges, the gross revenues and the ratio; and I think, brought up to date that is now 9.43 for the Canadian National; 4.18 for the Canadian Pacific, and 4.4 for the Class I roads?



A. Yes.

Q. So that the position is that the Canadian National's ratio is more than twice that of the Canadian Pacific?

A. More than twice that of the Canadian Pacific and more than twice that of the Class I roads.

Q. Then at page 55 you list the five roads there?

A. Yes.

Q. And according to these figures, the ratio with respect to those five roads varies from 7.88 down to 1.89?

A. Yes.

Q. For instance, comparing the ratio for the Pennsylvania Railroad with that of the Acheson, Topeka and Santa Fe System, we find that there is a variance in the ratio of the two roads to the extent that one is four times the other?

A. Taking those particular roads, yes. The Pennsylvania and the Canadian National do not show the same disparity as if you took the Class I roads as a group. On the other hand, if you take - -

Q. Let us take - -

MR. O'DONNELL: Let him finish, Mr. Covert.

Q. You started to say, "on the other hand, if you take - - "; what were you going to say?

A. I was going to say that if you take the road with the most favourable ratio, the Santa Fe, then our position by comparison is just that much worse.

THE CHAIRMAN: Q. Would you speak a little louder, please? What were those last words of yours?

A. Is just that much worse. If you compare the Canadian National with the Santa Fe by itself, their ratio in 1947 was 1.89 whereas ours was 10.48.





MR. COVERT: Q. If you compare the Canadian National, the Canadian Pacific and the Santa Fe in 1947, you would have the figures of 10.48, 4.60 and 1.89?

A. Yes.

Q. Is that not a . fairly clear indication in itself that there really is no true ratio, that the ratios themselves are not comparable?

A. That is why I took the Class I roads as a group.

Q. Yes.

A. I think that to compare the Canadian National with those five large United States railroads, you have so much difference in the comparative results that it is very difficult to draw a conclusion, except that the Canadian National, by any measurement, is out of line. But if you take the Class I roads as a group, I am submitting that that is the best thing you can do. If there is a better method, I should be very happy to produce the figures. But I cannot think of any better comparison than to take the Class I roads of the United States as a group and compare them with the Canadian National. In the group you have the good and the bad; you have the rich roads and the poor roads. By and large you have the United States railroads as a whole. By measurement the Canadian National Railways is about one-tenth of the Class I roads; and it is my submission that that is the best basis for comparison that I can suggest.

Q. As I say, the fact that you would take one road, the Pennsylvania, and the other one, the Santa Fe, and would show such a great variance in one year, would not disturb your idea of comparison?

A. No, it does not.



Q. Then I should just like to clear this point up, and I am looking at page 55. Suppose, for example, that the capital revision that you now suggest had been in effect during the years 1932-1947. Your ratio then would be vastly different from those of the United States roads during that period?

A. The comparison would obviously be very different.

Q. While we are dealing with that subject, Mr. Cooper, may I just ask you this question. In considering the question of the ratio of fixed charges, having regard to the United States roads and the Canadian National, it would be true that the considerations that applied as to why they had large fixed charges in one year and this continuous reduction, especially during the war years, would be different; there would be reasons for that which would not be really pertinent with regard to the Canadian National. Is that not true?

A. Oh, I think we have the same reasons. For example, - and I am looking at page 55 - the Canadian National ratio in 1932 was 37.05%, and we fell down just as the other railways fell down; the reason being, of course, that the gross revenues increased. Expressed as a percentage then the fixed charges necessarily are on a reducing scale.

Q. Have you any figures at all, Mr. Cooper, as to the possible write-down of investment in rail property that there should be in the Canadian National, for instance, if you went on the basis of depreciation of road property or if you were considering a rate basis?

MR. O'DONNELL: I think I might just comment here and say that we have not suggested anything of that kind

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in the Brief, as far as I remember. That is a study which would have to be made with another end in view than that which we have at the present time in making any submissions which have been made.

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(Page 18805 follows)





MR. COVERT: Well, Mr. Chairman, it would seem to me that one of the questions that may have to be taken into consideration by the Commission is whether or not the continuance of the requirements basis is proper.

THE CHAIRMAN: In fixing rates, do you mean?

MR. COVERT: Yes, is proper, or whether a rate base should be the desirable thing. Now, even if Canadian National has made no recommendation, the Commission might well want to know whether it is advisable for the Canadian National.

THE CHAIRMAN: Yes, I see. Well, do I understand that Mr. O'Donnell is objecting to giving you this?

MR. O'DONNELL: I don't object.

THE CHAIRMAN: So far he has not been keeping that in view, that is the point.

MR. O'DONNELL: I have not objected. I have simply said that there is nothing in the submission along that line. We have made no request for write-down of the property investment account. We have made submissions as to the adjustment of the capital structure with respect to the reduction in fixed charges and the providing of that fund.

THE CHAIRMAN: Yes, but when the theory is put to you, as Mr. Cooper just put to you then, what do you say?

MR. O'DONNELL: Well, I did not quite follow how he put it.

MR. COVERT: My point, Mr. O'Donnell is this. It might be conceivable that the Commission should recommend that the requirements basis for determining the



freight rates should disappear, and that the rate base method would be used. I understood you to say that the Canadian National had not made any recommendation with respect to that, and my point is that the Commission may be very interested in inquiring into the matter.

MR. O'DONNELL: Well, that would necessitate in my view a very careful study, and a very lengthy study possibly, as to what should be done in those circumstances. Rates have heretofore been fixed on the basis of requirements, and if the suggestion is that the basis is to be changed to a rate of return on a rate basis, then that gets to the position of determining what the proper rate base is. That is something that I would think requires very extensive study, and I was merely pointing out that in our submission we had made no request for anything of that kind at this time.

MR. EVANS: I think in fairness to my friend I should say that we believe very strongly that we must come to that basis for rate making, not because I want to embarrass my friend.

THE CHAIRMAN: You have laid your case with that in view.

MR. EVANS: Yes.

THE CHAIRMAN: Mr. O'Donnell at least knows that.

MR. O'DONNELL: Yes, I appreciate that. On the other hand it gets to this, as. I think my friend has said, as to what would be a reasonable property investment account in the circumstances. That is something which would come into play if the rate of return



theory is the basis upon which rates are to be fixed in the future, and, as I understand it, there is not much unanimity at the present time as to what the rate base should be. A rate base has been put forward and contended for, but it has not yet been accepted. It may ultimately be, I don't know.

THE CHAIRMAN: Mr. O'Donnell, may I interrupt to say this. We believe that that is a matter that we would expect to hear debated before us.

MR. O'DONNELL: Yes, well, all I was saying at this time, my lord, was that we had no submission in our Brief along that line.

THE CHAIRMAN: No.

MR. O'DONNELL: And that if it got into that field, which I think is a very extensive one, I would assume that very careful consideration would have to be given to it.

THE CHAIRMAN: What had you been assuming up to the present then, that the other method, the requirements method, was stabilized, was to continue without question?

MR. O'DONNELL: That has heretofore been the basis.

THE CHAIRMAN: Yes, I see. We think it is a matter we will have to hear argument about, and, of course, argument supported by evidence.

MR. O'DONNELL: We will be glad to give it consideration.

THE CHAIRMAN: But as I say, you have had the C.P.R. case before.

MR. O'DONNELL: That is true. We were letting



The first part of the book is devoted to a general survey of the history of the subject, and to a discussion of the various theories which have been advanced to explain the origin of the disease.

The second part of the book is devoted to a detailed description of the various forms of the disease, and to a discussion of the various methods of treatment which have been employed.

The third part of the book is devoted to a discussion of the various methods of prevention which have been employed, and to a discussion of the various methods of control which have been employed.

The fourth part of the book is devoted to a discussion of the various methods of diagnosis which have been employed, and to a discussion of the various methods of prognosis which have been employed.

The fifth part of the book is devoted to a discussion of the various methods of therapy which have been employed, and to a discussion of the various methods of surgery which have been employed.

The sixth part of the book is devoted to a discussion of the various methods of hygiene which have been employed, and to a discussion of the various methods of sanitation which have been employed.

The seventh part of the book is devoted to a discussion of the various methods of vaccination which have been employed, and to a discussion of the various methods of inoculation which have been employed.

The eighth part of the book is devoted to a discussion of the various methods of isolation which have been employed, and to a discussion of the various methods of quarantine which have been employed.

The ninth part of the book is devoted to a discussion of the various methods of disinfection which have been employed, and to a discussion of the various methods of sterilization which have been employed.

The tenth part of the book is devoted to a discussion of the various methods of prophylaxis which have been employed, and to a discussion of the various methods of prevention which have been employed.

The eleventh part of the book is devoted to a discussion of the various methods of control which have been employed, and to a discussion of the various methods of management which have been employed.

the C.P.R. run their affairs as we would like to be left to run ours.

THE CHAIRMAN: But in the final result the same measure will have to be used for both of you?

MR. O'DONNELL: I agree.

MR. EVANS: Perhaps I have given my friend an unfair impression of what I was trying to say. As I said at the beginning, we do not expect to decide what the rate base is in dollars or what the return is in percent, but I would expect to discuss the principles and to put them forward, not the details.

MR. MacPHERSON: Mr. Chairman, do I understand that my friend is suggesting that there be an amendment to the Statute in any way, providing what shall be done in the matter of fixing the rate base?

THE CHAIRMAN: Well, if Mr. Evans thinks that any amendment of the Statute is necessary to have his views prevail, he will have to prepare it, as everybody else has been doing, that is all; but he may think that no amendment is necessary.

MR. MacPHERSON: I have not understood him to that effect: I didn't think it was necessary and it was a matter for the Board as such.

MR. EVANS: I would not want my friend to be under any misapprehension. I don't think it is strictly necessary, but I would support one.

THE CHAIRMAN: You would what?

MR. EVANS: I would support an amendment to the Act to clarify this difficulty we have had. I don't think it is legally strictly necessary, and I have said that from the beginning.



THE CHAIRMAN: You thing that in the long run the question can still be left to the Board?

MR. EVANS: Yes, sir.

THE CHAIRMAN: As to how they will measure your needs?

MR. EVANS: Yes.

THE CHAIRMAN: That is what you think?

MR. EVANS: I would fully support an amendment to the Act if it is considered necessary.

THE CHAIRMAN: But you would not propose one yourself?

MR. SMITH: Amendment along what lines?

THE CHAIRMAN: As I understand it, the Canadian Pacific Railway is prepared to leave the Act as it is, that is to say, to leave it to the discretion of the Board, leave the question as to how rates are to be arrived at; built that if anybody does wish to amend the Act, making this rate base the compulsory method, the Canadian Pacific will support it. That is what you say?

MR. EVANS: Yes.

MR. MacPHERSON: I think our position would be to leave it to the Board as it now is.

THE CHAIRMAN: Well, I am not saying what will be done, but of course we may decide on something after all which nobody before us actually asks to to do. I think Mr. Covert is well advised to pursue that subject.

MR. FRAWLEY: As I understand the position under the law as it now stands, the railways may go to the Board under one or other method of asking for freight rate increases, so that it would require an amendment if the rate base method was to be made compulsory.



THE CHAIRMAN: You say the railways may go to the Board under either method?

MR. FRAWLEY: I mean, the Canadian Pacific can go to the Board.

THE CHAIRMAN: How could the Canadian National do that?

MR. FRAWLEY: Oh, well, I was thinking of the Canadian Pacific as the yardstick of course. Perhaps I should not have done. I find it difficult to change my thinking.

MR. EVANS: One of the few cases in which I would defer to the opinion of Mr. Frawley would be this, that if he has any doubts as to the Board's power to do this, I would then say I would advocate an amendment to the Railway Act.

MR. FRAWLEY: Yes, I think my friend should anyway get off the fence. He says "I will support something". Why doesn't he produce something?

THE CHAIRMAN: Mr. Evans, we did not catch what you said you would advocate.

MR. EVANS: I think this is one of the rare occasions on which I would defer to Mr. Frawley's opinion. He has now said he doesn't think the matter is clear, and I am saying, all right, I will take his opinion and I will advocate an amendment of the Railway Act; and if the Commission desires it and my friend desires it, I will draft it.

THE CHAIRMAN: Well, if you two gentlemen get together we shall certainly have a very fine draft.

MR. FRAWLEY: I am afraid my friend has misunderstood me. It is my impression, whether I am





expressing my mind, I said I think under the Railway Act as it now stands the Canadian Pacific can go to the Board seeking an increase on requirements or on a rate base. Of course it must prove that rate base and that is the big difficulty of course.

THE CHAIRMAN: That is where you begin to differ with it?

MR. FRAWLEY: On what goes into the rate base? Yes, indeed.

MR. EVANS: My friend did not quite say that. He said the Railway Act would be required to be amended.

MR. FRAWLEY: I said that if the rate base must be made compulsory to the exclusion of the other method, then there must be an amendment. That is what I said.

THE CHAIRMAN: Yes.

MR. FRAWLEY: I thought you misunderstood me.

THE CHAIRMAN: Well, Mr. Frawley, we are not taking it for granted that you are advocating definitely either method today, are you?

MR. FRAWLEY: No, that is quite certain, I am not advocating either method. We will meet the railways which ever way they go.

MR. COVERT: My lord, my thought was that we had Mr. Cooper here, a man of great and long experience, and I thought we should take advantage of his experience and ability and find out whatever information might be useful to us.

THE CHAIRMAN: Now, precisely what is this information?



MR. COVERT: Well, the first thing I wanted to find out was, if in his view it was possible to arrive at any figure for a rate base without a physical valuation of the Canadian National.

THE WITNESS: It is a subject, as counsel has said, that is a very involved one. I have not given it study and in view of the discussion to which I have listened, I think I would be foolish to inject myself into a matter of this kind at this time.

MR. O'DONNELL: May I just ask this, what you mean by the word "valuation" in the sense in which you have used it.

MR. COVERT: Physical valuation, physical inventory valuation. You would not care to express an opinion on that, Mr. Cooper?

MR. O'DONNELL: At this time.

MR. COVERT: Yes, at this time. Then the other question I would ask you is whether or not you had ever considered any write-down of the investment in rail property to keep them within any proposed recapitalization?

A. No, sir, and I refer you to what is said on page 63 of our main submission:--

"The large capitalization in relation to investment for the Canadian National is not important."

THE CHAIRMAN: Just a minute, where is this?

A. Page 63.

MR. COVERT: Yes, just following the figures.

THE WITNESS: "It is not suggested that the investment itself should be written down."

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Mr. Cooper

MR. COVERT: Q. Yes, I have read that. I asked you if you had ever considered a write-down in connection with recapitalization proposals?

A. No.

Q. You have not. In all your time with the Canadian National, Mr. Cooper, you have never attempted to prepare a balance sheet which would truly represent in your views the real investment in rail property?

A. I think our present balance sheet truly represents our investment in property, yes.

Q. I see, and that there is no necessity for any write-down?

A. It is not apparent to me that there is any necessity.

Q. And is it the test of the average cost per mile of road by dividing the per mile of road into the investment shown in the balance sheet and arriving at figures which you say are a third better than they are in the United States and only about \$2,000 worse per mile than the Canadian Pacific. Now, to arrive at that conclusion is that one of the tests you use?

A. That is one of the tests.

Q. And that would seem to be a pretty fair test?

A. Yes, I think it is a very good test. I would amplify my answer there, if I may.

Q. Yes.

A. That under the Interstate Commerce Commission theory of accounting for investment, the books of the carriers must be stated at historical cost.





THE CHAIRMAN: What is that last answer?

A. I said, my lord, that under the Interstate Commerce Commission method of accounting, the property account of the carrier must always be stated at cost.

Q. The property?

A. The property investment account.

Q. Of the carrier?

A. Yes, sir.

MR. COVERT: Q. Now, in tracing the property of the various railroads that have gone into making the Canadian National System, is there really any difficulty, Mr. Cooper, in arriving at the historical cost of the various properties that make up your rail investment ?

A. I would say that it would be humanly impossible to change our figures in the sense that going back to the year 1850 we could find better evidence which we would be satisfied to substitute for what we now know.

Q. I want to make sure I got that, Mr. Cooper. You mean that if you went back to 1850 you could not really get better evidence. Is that what you said?

A. That is what I said.

Q. So far as back to 1850 is concerned (and that is as far back as we would want to go) you say you could not get better evidence than is contained in the figures which are now in the Canadian National returns?

A. No.

THE CHAIRMAN: We will take a few minutes now.

---RECESS



---Upon resuming.

MR. COVERT: Q. Mr. Cooper, I think that in the brief of the Canadian National they stated that the value of the roadway property shown on the books of the company does not provide a proper basis for depreciation charges?

A. Would you refer me to that section, please? Is it at the foot of page 107?

THE CHAIRMAN: What is the page?

MR. COVERT: Q. Yes, page 107, at the foot, where you say:

"(a) Canadian National has no inventory of units of railroad property."

I think that was one of the reasons that you gave, that you should remain on the basis that you did not have depreciation accounting apply to your roadway property?

A. Yes, that is correct.

Q. Now, you will recall the discussion, I think, Mr. Cooper, when there was a reference to page 109 of Part II of the Canadian Pacific submission, that the company makes it clear that it has no objection to the revision of the Canadian National capital structure, as long as the Canadian Pacific is protected.

It seemed to express a fear that there is a possibility that the Canadian National may come to be used as a yardstick for rate making purposes. This may result from an alteration of the capital structure of the Canadian National, or from an alteration of its fixed charges, and that this would constitute a serious threat to the ability of the Canadian Pacific to continue to function as a privately owned railway system.

And then Mr. Walker of the Canadian Pacific

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appeared before us and his evidence appears in Volume 64, pages 13390 and 13391 where he makes a comparison between the Canadian National and a publicly owned company, and the Canadian Pacific a privately owned one; and I am, perhaps, summarizing what he says. I take it that he says that a comparison between the Canadian National and the Canadian Pacific will repay some analysis.

He points out that a reduction in the funded debt of the Canadian Pacific in the sixteen-year period was brought about mostly in the five-year period 1939 to 1943, and that to accomplish this, it was necessary to continue the passing of dividends.

This would indicate that he feels it is doubtful if any useful comparison can be made between the capital structure of the Canadian National and the privately owned corporation, the Canadian Pacific.

I wanted to discuss with you whether or not you had considered, in making recommendations for the revision of the Canadian National structure, its possible effect on the Canadian Pacific?

A. No, sir, not at all.

Q. I will ask you this, then.

MR. O'DONNELL: I think, Mr. Chairman, that it might be well at this point, possibly, for me to just say something with the thought in mind that it might facilitate the Commission's work and shorten the cross-examination, possibly, and the length of the hearings, even, if I made it clear just what the situation is.

In so far as the Canadian National is concerned, at this point, for the purpose of avoiding misunderstanding and clarifying the situation, I think it would be well for me to point out that the Canadian National has not asked to be made the yardstick. We have not made that proposal





anywhere for the purpose of fixing freight rates in Canada, and that such a result is not contemplated by the submission which we put forward. I think that should clarify the air a little as to the situation, in so far as we are concerned.

THE CHAIRMAN: Yes.

MR. COVERT: My only thought was, and I want to pursue it further: it seemed to me that there might be a possibility that this might result in the Canadian National becoming the yardstick.

For example, what I wanted to suggest to the witness was this: that if the Canadian National reached the position, by virtue of a reduction in fixed charges, that it showed a substantial profit, operating profit, and after paying the reduced fixed charges, and bearing in mind also the submission that they propose to change the position that has existed in the past, in other words, to keep any surplus and use it for the purposes suggested by Mr. Gordon, and to build up a rate stabilization fund, that that might result in their becoming the yardstick.

THE CHAIRMAN: Do you mean to say that it might result in the Board preferring to take them as the yardstick?

MR. COVERT: It might do that, or it might result in this: for instance, Mr. Frawley made it clear -- I think his view is that the Canadian National should not operate at a profit, that it should not make money; that it should provide the services at cost. I think that is a pretty accurate statement of Mr. Frawley's position.

MR. FRAWLEY: I think Mr. Covert refers to my examination of Mr. Thompson, in which I queried the suggestion that the Canadian National should pay dividends to the Government of Canada. To me that was fundamentally

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the opposite of what a publicly owned corporation is, or should be, or was intended to be. That is all. My submission is that there should be no such a thing as a synthetic Canadian National Railways, and it would be synthetic if it began to pay dividends to the Government of Canada.

I was pleased to find that Mr. Cooper, providing I interpreted him correctly, was of the same opinion, and that he did not think that the Canadian National should be paying dividends to its owners, because its owners were the people of Canada.

I wonder if Mr. Covert would allow me to interrupt him.

THE CHAIRMAN: You are talking of dividends merely as a manner of disposing of money which is in the possession of the company?

MR. FRAWLEY: No, no.

THE CHAIRMAN: This has nothing to do with the cost of the freight rates. It may very well happen that the Canadian National might have a surplus as well as a deficit. In fact, they want to have a surplus, and then they must make some disposition of it. But you say that no part of that surplus should be paid to the Government?

MR. FRAWLEY: I simply stop there. I do not know how a Crown owned company or a publicly owned company could pay dividends to its owners.

THE CHAIRMAN: I do not think it is asserted by the Canadian National at any place that they want to pay dividends.

MR. FRAWLEY: I understand that.

THE CHAIRMAN: Have you dealt with it?

THE WITNESS: No, sir. The only reference I made to it was to deny that it should be understood that





the Canadian National is not to be permitted to earn a return on its equity capital.

That is as far as I have ever gone. I do not think I have suggested anywhere that the Canadian National, as a general policy, should not pay dividends. I have never discussed it.

MR. O'DONNELL: I might say that possibly it might be well to allow the matter of the rate stabilization fund to remain in abeyance until it has been explained by Mr. Fairweather. You will remember that Mr. Cooper suggested that Mr. Fairweather would be giving evidence concerning it. And until that is done, it would be, in my respectful view, premature for us to go into it.

THE CHAIRMAN: I think we had better be prepared to go into it.

MR. COVERT: I just want to state my difficulty.

THE CHAIRMAN: Pardon me. There is no equity capital in the hands of the public?

THE WITNESS: No, sir.

THE CHAIRMAN: It is all Government. All right, go on.

MR. COVERT: My difficulty is this. Mr. Gordon stated that any surplus earnings would be used for two purposes.

One of them was to establish a rate stabilization fund which, it is hoped, could be built up in good years and drawn upon in poor years, with the view of affording stability to the rate structure and tending, to the extent of the fund from time to time existing, to postpone the necessity for applications for general freight rate increases.

Let us assume that they did have good years and that they had built up a substantial stabilization fund.



I have been thinking of you very much lately.

I hope you are well and happy.

With love from all of us,

Your affectionate friend,

John Doe

P.S.

I will be home next week.

Write to me when you have a chance.

Love, John Doe

I am sure you will be very happy.

With love from all of us,

Your affectionate friend,

John Doe

I will be home next week.

P.S.

I will be home next week.

Write to me when you have a chance.

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Then I can only read into that thing that if they had a substantial rate stabilization fund in existence --

THE CHAIRMAN: Yes, as a result of some years' earnings?

MR. COVERT: That is right; and if they had that, and if the Railway Association wanted to apply for an increase in rates, then the Canadian National might say: No; we have a stabilization fund which makes it unnecessary to apply for an increase.

Therefore it would seem to me that, right there, possibly the Canadian National would then be the yardstick because, if they did not join in the application -- if they did not join in the application -- and the Canadian Pacific went, alone, to the Board and secured an increase, then the Canadian National might say: We do not join in the increase and we do not put in the increased rates. What is the position?

THE CHAIRMAN: I don't suppose you could have that position, because you would have the railways running at different rates.

MR. COVERT: Yes.

THE CHAIRMAN: I read this to mean that in each case the Canadian National would not be under the compulsion of initiating an application for increased rates.

MR. COVERT: That is right; and my point is: supposing they not only did not have to initiate it, but did not join in it; or suppose they did join in it, and the Board of Transport Commissioners then said: Well, we will still use the Canadian Pacific as the yardstick.

Then the rate stabilization fund would continue to grow in the Canadian National, presumably. And then I wanted to find out this: Might it not be that public pressure would say, here, look at the Canadian National

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profits, and they would insist on lower rates.

That is why I wanted to see if possibly a rate stabilization fund of this kind, brought about possibly by a reduction in the funded debt of the Canadian National, might not lead to public pressure which would really make the Canadian National the yardstick.

THE CHAIRMAN: Generally applications for rate increases are based on the future, on the present and the future. Isn't that the case with conditions now? That they show that from here on we shall require higher rates up to a certain point, and that is, regardless of what has been done in the past?

MR. COVERT: Yes.

THE CHAIRMAN: And in the case of privately owned companies, their system of distribution does not afford any difficulty. But here we have a Government institution which is in a very different position.

In that case, any surplus it has is earmarked for respective purposes, either for ploughing back into the railway itself, or they will say: No, we do not want to support this thing.

These applications do not come on every year or every five years. Therefore they would not be under the necessity of initiating an application for freight rates as soon as the Canadian Pacific. I do not think it would mean that they would stand aside.

MR. O'DONNELL: I think, my lord, it would be well for us to delay this until Mr. Fairweather has explained it, and what it means as far as the Canadian National sees it, and the extent of it.

Might I say this: that if the Canadian National happened to be able to get a surplus, or to get moneys as part of the proceeds of a just and reasonable rate, then so would every other railway in Canada.

(Page 18825 follows)





Now, the purpose of this is that the Canadian National should be permitted to hold some portion of the proceeds of the just and reasonable rate which every railroad in Canada will have. The C.P.R. today is entitled to withhold such portion as it is able to save over and above paying its operating costs and its fixed charges and its dividend requirements; if there is anything left it can hold it. To date if there is anything left the Canadian National has, as a matter of practice, turned it over to the Government. That is the object of the thing. We wish to be able to retain some portion if we have any of the just and reasonable rate, and there is one rate for everybody and every railroad will get to the same extent money such as we would have. The object of that is, it is really in effect a reserve fund. If we have a little money we would like to hold it.

THE CHAIRMAN: Yes, but you would not be paying dividends, apparently.

MR O'DONNELL: Well, that has not so far been suggested.

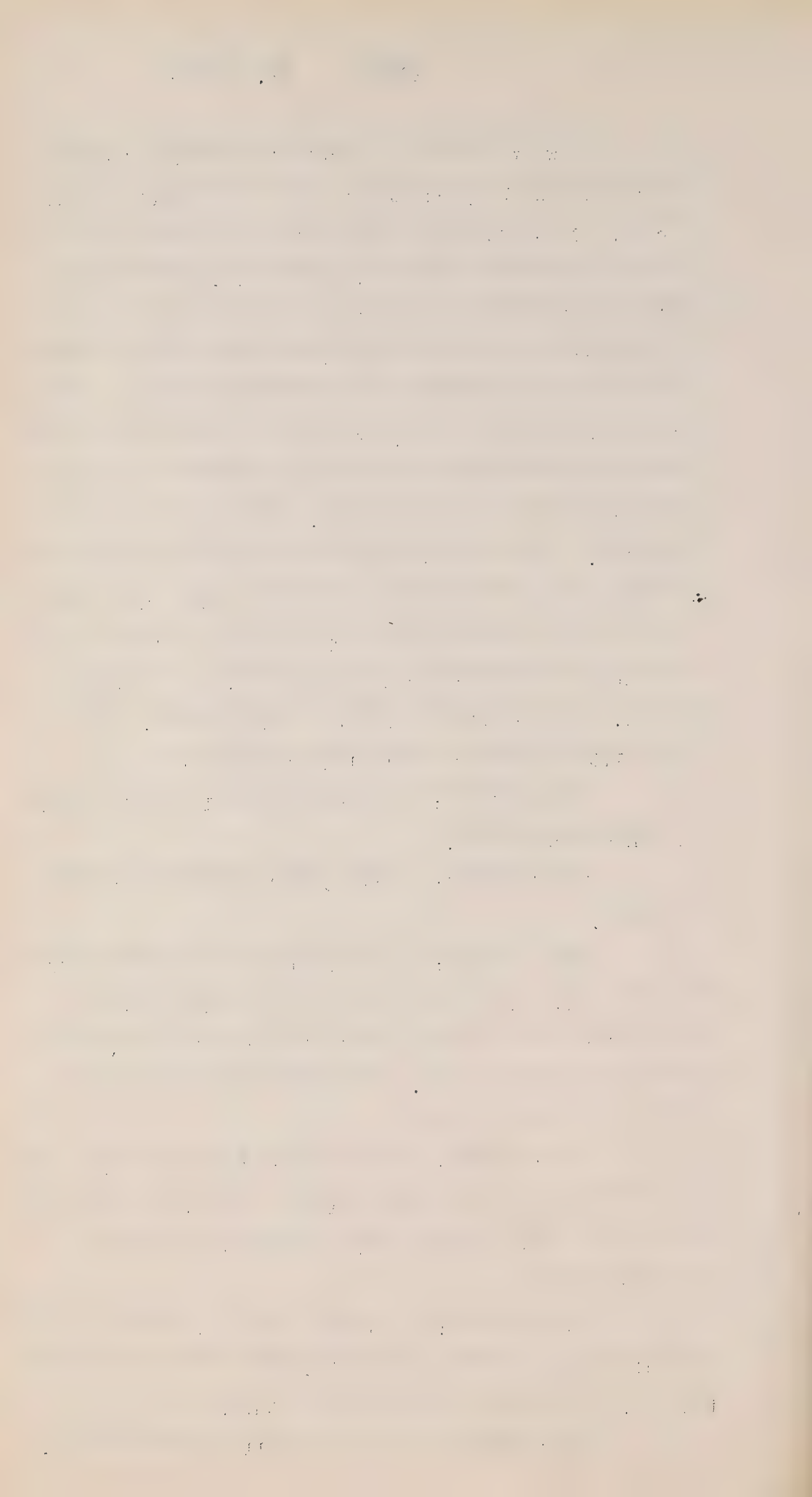
THE CHAIRMAN: Your surplus would take a different form, and I think Mr. Covert has in mind that the public might say, "Well, here is the Canadian National with these funds on hand. Why should there be any increase in freight rates?"

MR O'DONNELL: The Canadian National would only have those funds to the extent that every other railroad had had them and received them concurrently with its receiving them.

THE CHAIRMAN: I think I see Mr. Covert's point very clearly. I think your best answer just now is, wait till Mr. Fairweather disapproves of this.

MR O'DONNELL: Yes, wait till we hear from Mr.





Fairweather.

MR FRAWLEY: I think, my lord, in view of Mr. O'Donnell's statement that the Canadian National had never asked to be made a yardstick, it might be useful to call to the Commission's attention just what he did say in the 20% Case. He said at page 4104:

"Before engaging in any argument regarding that matter there are two preliminary observations which I would like to make. First, I submit that the Canadian National Railways are a factor in freight rate making today in Canada even though they were not taken as the yardstick of measurement in the 21% Case.

In the 21% Case the respondents" -- that is, the provinces -- "contended that the position of the Canadian National Railways should, for the various reasons advanced by them, be disregarded completely when examining the application made in that case for an increase in freight rates, although throughout the case they frequently made reference to and used figures and data of the Canadian National Railways for the purpose of comparison with those of the other major roads.

On behalf of the Canadian National it was argued that the respondents' contention was unfounded."

Then Mr. O'Donnell gave page references for the argument that he made in the 30% Case.

Now, the Chief Commissioner said this:

"THE CHIEF COMMISSIONER: I am just going to interrupt here.

MR O'DONNELL: Yes, my lord.

THE CHIEF COMMISSIONER: To my mind, that is the most important statement that has been made in the argument yet and it is a factor in the whole case that has not been dealt with.



MR O'DONNELL: Yes, my lord.

THE CHIEF COMMISSIONER: Now, I just want to be clear what your submission is. Your submission is that the needs of the C.N.R. are such that in any disposition of this revision and additional application that is before us, you submit that this application and revision should not be disposed of entirely having regard to the position of the C.P.R.

MR O'DONNELL: That is correct.

THE CHIEF COMMISSIONER: That regard should be taken of the C.N.R.

MR O'DONNELL: That is right."

And then he goes on.

Then the Chief Commissioner said this in his judgment at page 10:

"However in view of the strong representations made by counsel for the Canadian National Railways in his final argument that the increase in freight rates should substantially meet the requirements of the Canadian National Railways, I am of opinion that the final determination respecting this application must await the findings of the Royal Commission on Transportation, and possibly the implementation of certain of those recommendations because one of the matters referred to it by Order in Council P.C. 6033, 1948, is to 'Review the capital structure of the Canadian National Railway Company and report on the advisability, or otherwise, of establishing and maintaining the fixed charges of that company on a basis comparable to other major railways in North America.'"

I only point that out. My friend did not say there they should be the yardstick, but at least now that is the position he took before the Board. You see the importance





the Chief Commissioner attached to it, and I say therefore you see the importance to the Board, this continuing Board, be it that Chief Commissioner or any other; and now it is a matter to be solved by your lordship and your fellow Commissioners. I thought that should be clear when this matter is being pursued, because it does make a difference for our cross-examination.

If the Canadian National is content to stand aside completely and say, "Fix the freight rates on the basis of the Canadian Pacific's requirements or the Canadian Pacific's rate base, as the case may be, and we will take it, be it bitter or be it sweet," that is one thing, but for them to say, "You must have your left hand thinking about the Canadian National while you are endeavouring with your right hand to fix a rate to take care of the C.P.R.," that is a rather unsatisfactory position, and I think, putting it in one word, that was why we objected in the revenue cases, and we succeeded in having the Board take the Canadian Pacific solely as the measure or guide of the fixing of freight rates.

I merely made this interjection so that what I think is the importance of it to the Transport Board could be placed before the Commissioners at this time.

MR O'DONNELL: Well, I think that is fair enough. I agree that I made an argument, and I agree that the judgment did not go on with the argument, and that the rates were fixed on the basis of the Canadian Pacific's requirements; I agree with that. I merely said that in so far as this Commission is concerned there had been no request put forward by the Canadian National Railways, to be made the yardstick, and I suggested that it might clarify the situation if I drew that to the attention of the Commission, and that is why I said what I said. I merely said that, not having asked





to be made the yardstick, such a result is not contemplated by the Canadian National submission, nor can it follow from the adjustments which have been requested.

THE CHAIRMAN: Do you really mean this, now, Mr. O'Donnell, that if you get all that you are asking for here in other respects, of course you will never have to be the yardstick?

MR O'DONNELL: Well, unless a lot of other things happen in the interval and some factors that would come into play do come into play and are given consideration. Certainly as far as we are concerned we have not asked to be made the yardstick.

THE CHAIRMAN: You do not expect to have to be.

MR O'DONNELL: Well, I do not know what ten years or fifteen years may bring about.

THE CHAIRMAN: So far as I understand, in the C.P.R. case they never intended to exclude the C.N.R.

MR O'DONNELL: I do not think they did, no.

COMMISSIONER ANGUS: Mr. O'Donnell, if we take Mr. Gordon's statement about affording stability to the rate structure, if the rate structure depends exclusively on the position of the Canadian Pacific Railway, how can any fund that is held by the Canadian National Railways afford stability to that rate structure?

MR O'DONNELL: We shall have to explain to you, Dr. Angus, through Mr. Fairweather, what we mean by stability in that way, and I think that it would be well if we left the subject until that point. Mr. Cooper is not the man who was to deal with it; Mr. Fairweather is. Frankly, I feel that when you have heard the way in which it is contemplated that fund will be used, it will not scare so many people or give them too much worry.

THE CHAIRMAN: You had better take it that way,



then. Mr. Fairweather will give us the necessary information.

MR COVERT: Q. Mr. Cooper, is there any suggestion advanced as to any method which might be used to maintain the fixed charges of the Canadian National on a comparable basis with those of other roads?

A. I do not think so, in this submission.

Q. If it is important that there be a comparable basis, then that must not surely apply just at this moment; you must think that that basis be maintained over a period of years?

A. Yes.

Q. Now, how would that be done? How would it be maintained?

A. Our trouble in the past has largely been due to the fact that we had nothing to come and go on. Under this proposal, and granted good business conditions throughout the country, and granted a reasonable relationship between costs and revenues, we should have something to come and go on, and it is by avoiding the necessity of continually borrowing debt for every cent of capital expenditure that we feel that there will be some control by us over the fixed charge debt of the company.

Q. Then what you feel is that if all these conditions pertain you will be able to maintain it?

A. Yes.

Q. I will put this to you: If a depression occurs and you have deficits, then you would look to Parliament to vote money to pay those deficits?

A. That would depend on the period at which the deficits occur. If we had had a few years of reasonable net earnings which we were able to retain, as has been suggested, it is out of that that we would pay deficits. There would



be no necessity to go to Parliament. If we started off after the adjustment with deficit conditions, there is no escape.

Q. Now, what I want to find out is, in a condition such as that would deficits not be covered by funded debt?

A. Oh, never.

Q. Never?

A. No, never. We could not issue funded debt to finance deficits. I remind you of what the Duff Commission said in that respect: "Income deficits shall not be funded." That is one of their major recommendations.

THE CHAIRMAN: Q. Repeat the formula again?

A. They made the recommendation, sir, or the declaration, that income deficits shall not be funded.

MR O'DONNELL: That is section 12, is it not, of the C.N.-C.P. Act?

THE WITNESS: I am speaking of the Duff Report. It was written into the Canadian National-Canadian Pacific Act, and it was declared to be the policy of the Government. The Minister of Finance in March 1933 got up and said, "That is the policy of the Government from now on."

THE CHAIRMAN: It might be just as well if we had the Act read to us. You have it, Mr. O'Donnell?

MR O'DONNELL: I might just read, in keeping with your request, my lord, section 12 of the Canadian National-Canadian Pacific Act, as amended by the statute 1 Ed. VIII, chapter 25, 1936:

"12. The annual budget of National Railways shall be under the control of the Board of Directors. Estimates of the amounts required for income deficits, for interest on obligations outstanding in the hands of the public, for capital expenditures and for refunding or retirement of maturing securities shall be submitted





by the Board of Directors to the Minister of Transport for the consideration and approval or disapproval in whole or in part of the Governor in Council and thereafter presented to Parliament. Income deficits shall not be funded. Amounts provided by Parliament to meet capital expenditures shall not be diverted to cover deficits in operation unless with the express authority of Parliament."

Incidentally, this section had previously been in 23-24 Geo. V, chapter 3.

MR COVERT: Q. Now, Mr. Cooper, I put to you another matter. Supposing just after your capital was revised we had a depression and you had operating deficits and you wanted to dieselize your whole system, and you satisfied the Government that this was feasible, that it would save money, and they advanced you the necessary money to enable you to carry out that programme---

THE CHAIRMAN: What is the programme?

MR COVERT: Q. A dieselization programme, including in it general improvement of your whole system, your terminal system, and so on -- in other words, it might possibly be done as part of a public works programme in a time of depression, it might be considered advisable to do it. Now, what I am suggesting to you is that the Canadian National in circumstances like that might be in an entirely different position than the Canadian Pacific?

A. It would depend, I think, on the degree to which the projected works were deemed to be measures of public assistance as compared with ordinary railroad requirements. We had that situation in the depression years. The Government of Canada lent money to both the Canadian National and the Canadian Pacific. I may be wrong in this, but I am under the impression that the Canadian Pacific still have liability to



the Government of Canada for some of the moneys that were advanced under such conditions in the depression years, and I assume that if it were considered by the Government of the day to be in the interests of the nation to do things of that kind they would do them.

Q. At that point, supposing they advanced moneys to both, do you think that they should be so advanced that your ratio of funded debt would continue the same?

A. If they were measures of public assistance, my suggestion or thought would be that they would be more or less without interest to both companies.

Q. When you say without interest, do you mean that it would not be funded debt at all?

A. It could be funded debt, but it would not necessarily carry an interest rate.

Q. You mean forever?

A. No. It could have some restrictions; I think there are restrictions on what was done before.

Q. You mean for a certain period there would not?

A. Yes.

Q. Eventually you would say that they would be funded debt in those cases, for both, and that you would endeavour to maintain the comparability as far as amount of funded debt was concerned?

A. It would be indebtedness. I am not so sure it would be funded debt.

MR O'DONNELL: Q. It would depend on the conditions on which the Government gave it to you, wouldn't it?

A. Quite.

MR COVERT: Q. What I am interested in is whether or not this comparability between the funded debt which you say is to be desired -- whether there should be an attempt to maintain it?



A. That is one of the matters referred to the Commission for consideration -- the establishment and the maintaining of a proper relationship of Canadian National fixed charges with those of other railways.

Q. Is it fair to say, Mr. Cooper, that you think that the comparability should be maintained?

A. Yes, yes.

Q. Now, Mr. Cooper, there was one thing I wanted to clear up. I think you said that ever since 1923 the Canadian National had had to borrow every cent they had spent on capital expenditures; that was in volume 99, page 18579.

A. I think that is a true statement.

Q. Now, I just wanted to clarify a point there. It seemed to me that somewhere I had seen that you had said, \$117 million out of depreciation accruals and \$131 million out of surplus earnings. Were there capital expenditures of those amounts made out of depreciation accruals and out of surplus earnings during the war years?

MR O'DONNELL: Would you give us the reference, Mr. Covert?

MR COVERT: The reference to the first one was 18579; I regret to say I am unable to make out my writing.

THE WITNESS: On page 42, I think.

MR COVERT: Q. Page 42 of the main brief?

A. Yes. Well, I think you have got a point there, Mr. Covert, against me.

THE CHAIRMAN: Just a moment, now.

MR COVERT: What I wanted to do was to see if I could clear that up.

THE WITNESS: Yes.

THE CHAIRMAN: I want to make sure that we understand what is to be cleared up. What is the point on page 42?





MR COVERT: Perhaps Mr. Cooper would explain that. It seemed to me that the two statements were a bit inconsistent, and perhaps Mr. Cooper would explain.

THE WITNESS: I agree with that. On page 42 we show that we had surplus earnings between 1941 and 1945 in the amount of \$112,502,062. Now, we used those moneys to retire Government loans. That money was not used for capital expenditure. But the depreciation accruals, amounting to \$117,582,140, undoubtedly were used to finance additions and betterments, and of course there can be no question that that is proper procedure.

MR COVERT: Q. But it does change that statement that appears on page 18579?

A. Yes. I confess an error on that point.

Q. I just wanted to clear the record. Then there was a point that I think perhaps may need a little clarification. I just want to make sure that I understand it, Mr. Cooper. It is in volume 99, on page 18514 -- perhaps I should refer you back to 18513. You are discussing that \$12 million figure in Mr. Gordon's statement, which is the capitalized figure to cover your deficiency in operations of I think five or six railways that had been taken over in 1929?

A. Yes.

Q. Now, I just wanted to clear this up. You took a period of 1929 to 1939 and you showed a net average deficiency of \$908,000 a year on those lines?

A. That is correct.

Q. Now, if you capitalized that you say it would be \$30 million, and you say you are just taking \$12 million, which you say is a very conservative figure?

A. Yes.

Q. Now, I wanted to find out why you had been so con-



servative, and I thought that it was probably because 1929 to 1939 might be poor years to take, and you had stopped during the war because, as you said, you had more important things to do, and that perhaps they may have been better in those later years and that is why you took such a cut from the 30 to the 12?

A. It would be one of the considerations.

Q. Are there others, Mr. Cooper?

A. Well, there is the feeder value of these lines to the main railway system, which comes from traffic which originates or is destined to these branches.

(Page 18840 follows)



MR. COVERT: Q. There was one point, in Volume 100. I am not suggesting that you should supply the information, but perhaps it could be supplied to us.

THE CHAIRMAN: What volume?

MR. COVERT: Q. It is in Volume 100, at page 18652. Mr. O'Donnell had asked you to deal with the \$300 million figure, and you said:

"A. The extent of the relief set out in his statement represents the decision of the President himself. I do not know all the considerations he had in mind in making that decision. I know, however, three of them which are as follows: --"

It did seem to me that if there were other reasons than the three which you suggest, they should be made known to the Commission. Perhaps Mr. O'Donnell will see to that?

MR. O'DONNELL: All right.

MR. COVERT: Q. Then one of your difficulties, Mr. Cooper, is that you say your financial statement should be comprehensible to all. I think you referred to the present unwieldy capital, and that people just do not understand it.

A. I think that is general, yes.

Q. May I ask you this: You would not expect ever to produce a balance sheet and financial statement of the Canadian National which everybody would understand?

MR. O'DONNELL: Do you mean everybody outside of Grade I?

MR. COVERT: Q. I mean that there is some limit to the number of people who would be expected to understand it, or expected even to read a balance sheet. I want to find out.

First of all, it seems to me that the Board of





Transport Commissioners in recent judgments have suggested, and have written into the record for the future, that the Canadian National is an efficient railway?

A. That is generally admitted today, yes.

Q. And don't you think that the situation with respect to the Canadian National, their difficulty about the funded debt is well known throughout the country?

A. Yes, but it is a matter of general disrepute, and it doesn't seem to me that just because it is well known constitutes a reason for not correcting it.

Q. No, but I am pursuing it to this extent: that may have been the situation once, but I am suggesting to you that perhaps it has changed, because the Board of Transport Commissioners has come along and said: Here, the Canadian National is efficient.

I think the Canadian Pacific has publicly stated that you are efficient; and I think there appeared before us one of the unions which said you were efficient.

And certainly, the officials of the Canadian National itself think they are efficient, and they understand this. So I was just wondering if, under those circumstances, it would not be easy to prepare a balance sheet which could express <sup>what</sup> your operations -- what your operating revenues are, and compare your operating revenues with those of other railways, and make simple notations showing how you have an over-all deficit because of your fixed charges; I wonder if that would not overcome this psychological factor which you refer to?

A. Putting that question to me as an accountant -- of course, you are putting it to the very last person in the world that you should address the question to.

I am here to state the accounts as reflecting what exists. The accounts of the Canadian National Railway



should be a true reflection of the factual situation. And if the factual situation is wrong, you should not ask an accountant to make the correction by changing his method of accounting and producing something which is not true and according to the facts.

Q. Would you say, Mr. Cooper, that the important thing is your operating results?

A. Much more so than the balance sheet, yes.

Q. Now, if your operating results, without regard to fixed charges, are shown, does not that, in effect, give the true picture of the Canadian National?

A. Nevertheless the fact remains that however good our operating results are --

Q. You end up with a deficit?

A. The words are put into the headlines across the newspapers: Canadian National deficit for the year 1949 \$42 millions.

That is what you are going to read, and you will read it very soon. It is that sort of thing.

If everybody would stop at the operating results and say: We are not interested in the rest, we do not care how much you lose, we do not care how much you go to the Government for financial assistance, that would, perhaps, meet the point you have in mind. But that is not according to the conditions with which we have to deal.

Q. Just one final question, and it is this: You have expressed in the brief, I think, in several places, perhaps in different ways, but you have said that the Canadian National must operate as both a business enterprise and it also must be an instrument of national policy?

A. Yes, I agree with that.



Q. Now I am asking you: Can it be both, in your view?

A. It is both at the present time.

Q. Yes, and then be put on a comparable basis as to fixed charges with other roads?

A. In my opinion that can be done.

Q. It can be done? That is all. I thank you very much.

THE WITNESS: Thank you.

THE CHAIRMAN: I think we had better adjourn until a quarter to three.

---At 1 p.m. the Commission adjourned until 2.45 p.m. today.

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Ottawa, Ontario,  
March 22, 1950.

A F T E R N O O N     S E S S I O N

MR. COVERT: Mr. Chairman, I thought before Mr. MacPherson started I might ask the Canadian Pacific to file, if they would, an exhibit similar to Exhibit 250 that was filed this morning. That was the estimated revenue accruing had rate increases become effective one month subsequent to date of application. I thought we might have a comparable exhibit.

THE CHAIRMAN: What do you say, Mr. Evans?

MR. EVANS: We will be quite happy to do so. I mentioned to my friend, Mr. O'Donnell, that I had some reservation about one figure in that, and I would be inclined to say that our comparable exhibit would not be quite comparable. I have told my friend that I think the item of 15% increase in competitive rates -- I do not suggest there is any inaccuracy in it -- has been treated in a way that perhaps my friend would not have done had he had the discussion with me that I had with him this morning. I have in mind this, that the item -- I think it was \$10,000,000 -- on that exhibit with respect to the 15% increase in competitive rates effective September 15th, 1948, has been restated on the basis of 22 months. I am not suggesting my friend is wrong but my own view would be that that 15% increase in competitive rates was more clearly related to the application for a 20% increase which took place in July of 1948, and that therefore it perhaps would be fair to my friends, the provinces, to say that I would restate that as though that increase flowed from the 20% application, and would apply as from a date one month after that application was filed. I am not for a moment suggesting my friend is wrong, but it just struck me at the time, and I



mentioned it to him. I don't know whether or not he has got any views to offer.

MR. O'DONNELL: I might just say that my friend's friend had nothing whatsoever to do with the statement, and I did not see it until it was put in this morning, but I will be very glad to discuss it with Mr. Cooper, and see that it is put in properly and on the fairest basis possible.

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T. H. COOPER, RECALLED

CROSS-EXAMINATION BY MR. MACPHERSON:

Q. Mr. Cooper, we had some evidence from the Canadian Pacific indicating that in the matter of their passenger traffic there was a loss. I presume there would be the same experience with the Canadian National?

A. Yes.

Q. Their figure was around \$30 million and yours would be approximately the same, I suppose?

A. I don't know what our figure is, Mr. MacPherson.

Q. But it would be reasonably substantial in any event?

A. Yes, it would.

Q. So that in the last analysis freight carries the load for the railways, doesn't it?

A. Yes.

Q. Makes up deficits in any other services and takes care of the situation generally from the standpoint of dollars for the road?

A. In our case it did not make up the deficit, of course.

Q. But the treasury made up the deficit?

A. Yes, sir.

Q. But generally freight does carry the load?

A. As a general proposition, yes.

Q. And that being so I am naturally concerned on the





part of the provinces, and particularly one of them where the long haul is very vital, as to the approach that will result from the adoption of this plan of Mr. Gordon's, and as I understand it, as far as you can go from what you said this morning, Mr. O'Donnell, is to say that the C.N.R. will not seek to be a yardstick.

MR. O'DONNELL: Has not asked to be the yardstick.

MR. MACPHERSON: Q. In the applications during the past three years it was urged that the requirements of the Canadian National be taken into account. This would very definitely change the requirements of the Canadian National, would it not, if this scheme were brought into being?

A. It would depend on your definition of requirements. If Canadian National requirements were interpreted in the same way that Canadian Pacific requirements have been interpreted, meaning fixed charges, a return on equity capital, something to come and go on, I do not think it would affect the position very much. My thought would be that if rates were fixed on that basis perhaps the position of the Canadian Pacific would be improved.

Q. The position of the Canadian Pacific would be improved?

A. Yes.

Q. That is important in the matter of its position in applying for an increase in rates?

A. Yes.

Q. That is, strengthened?

A. It would not be injured if --

Q. I am looking at it, as you understand, from the point of view of the man who pays the freight, Mr. Cooper, and I am concerned, having been through the rate cases in the last three years, with what the situation will be if Mr.





Gordon's scheme becomes a fact, how it is going to affect the freight payer?

A. I do not think it affects requirements at all, if requirements include fixed charges and equity capital. It simply moves an item which is now a requirement of ours under the heading of fixed charges into a requirement which would become a return on equity capital. Unless you change the definition of requirements as applied to the Canadian National from what it has been interpreted as applying to the Canadian Pacific I do not see that this proposal affects total requirements at all.

Q. Well, if you take this new proposal you are going to have in equity capital a very large sum of money, are you not?

A. Yes, sir.

Q. And if you ask for a return on that then you might very well still be in a position where you could make a request for freight increases, and where your needs would be greater than the needs of the Canadian Pacific?

A. Yes, if Canadian National requirements are used as Canadian Pacific requirements have been, and if requirements are defined as Canadian Pacific requirements have been defined it seems to me that the need for a high level of freight rates would become apparent.

Q. And without any striking out of any money in your capital structure at all, everything simply being transferred to that equity capital, it might very well mean if a return is asked on that total that the freight payer will be in a worse position than he was before in respect of applications before the Board of Transport Commissioners?

A. That, of course, is on the assumption that the Canadian National is a part of the yardstick, or the yard-



stick, which, as Mr. O'Donnell has said, has not been suggested.

Q. It has not been suggested but I am trying to find out where my people will get off at if this is adopted. That is as far as you would care to go in connection with it?

A. Yes.

Q. Now, Mr. Cooper, taking Mr. Gordon's statement, where he takes the sum of \$1,533,000,000, which is on page 14, when he takes that sum it is not suggested at all that the capitalization of the Canadian National is over-stated by that amount?

A. No, sir, it is the amount of capital which carries an interest charge including in that figure some proportion of what has been termed negative capital. The figure of \$1,533,000,000 of course exceeds our total fixed charge debt, and the explanation of that is in the total of \$1,533,000,000 something has been added representing capitalization of the annual deficits on some of the thin traffic lines.

Q. But you are transferring this whole total to equity capital?

A. Not all of it, sir.'

Q. You are transferring --

A. \$760,000,000.

Q. \$760,000,000?

A. That is right.

Q. Which is now bearing --

A. Interest.

Q. Interest, and which would not bear interest?

A. That is so.

Q. There is just one point, Mr. Cooper, referring to certain evidence you gave this morning. You were referring to the figures which are found, I think, on page 43 in table 6, investment in road and equipment of the railway. The figure there as of 1947 is \$2,009,000,000. Now, you told Mr. Covert,





as I have it, that you could not get better figures. That simply means these were the only figures you could get?

A. Yes, that follows. I should perhaps explain what this figure is.

Q. Yes.

A. The Canadian National system is the successor of the Grand Trunk, for example, and the other three big railways. The Grand Trunk in turn was the successor of a number of systems such as the Midland Railway system, the Great Western system, and the Midland and the Great Western and the Northern in turn were the results of consolidation of still prior corporations. So that what we have today centralized in the Canadian National system begins with all the small lines which were built back at the beginning of railroading in Canada in the 1840's. Their books of accounts were brought forward. I have not seen them. They do not exist today. Nobody knows where they are or how they were compiled, but these figures have all been brought forward through the years and they are carried into our accounts at 1923 as we found them in the ledgers of the various corporations, and from that date we took full responsibility for them.

Q. As you say at page 44, "Their accounting was not under regulatory authority"?

A. That is so.

Q. "It followed the judgment of the accountants or the policy of the owners. On transmission the investment account often was determined by the par value of the securities issued in exchange."

That is the fact as you know it?

A. Yes, it is.





Q. Then at the bottom of the page you say:

"All one can claim then for the present ledger figures is that they are the historical costs, recorded by many persons, under different accounting theories, in many different books, over a long period of time. As such they should be preserved and continued."

And that is of necessity the basis on which you had to work in arriving at this final total of two billion nine?

A. Yes, that is a frank statement of how that figure was arrived at.

Q. Now, when you come to page 14 of Mr. Gordon's statement again the first item there is \$804 million?

A. Yes.

Q. Now, that was the funded debt of the Grand Trunk and the Canadian Northern systems held by the public as at December 31, 1922, wasn't it?

A. Including the Grand Trunk Pacific, yes.

Q. Yes, both of them, and the Grand Trunk Pacific?

A. Yes.

Q. Is it your opinion that some large portion of this or any of it should have been written off?

A. Based on the past earning record of those companies, I think that substantially all of it should have been written off.

Q. Substantially all of it should have been written off?

A. Yes.

Q. And yet so far as the capitalization is concerned, much of it you would take into equity capital at this time and have it recorded there?

A. Yes. When I said written off, I perhaps should have been a little more precise and said that it should have been converted into equity capital instead of being continued



as fixed charge capital.

Q. What you mean is, if it had been an ordinary business concern---

A. And gone through---

Q. And gone through the wringer, as the term is used I think with the railways in the States, then that would have been written off completely and would have disappeared?

A. I would not say written off, no; I would say the debt would have been changed into equity capital.

Q. Well, would there not have been an elimination completely of a certain figure?

A. Well, that is rather hypothetical, but in railroad accounting we do try to hang on to these so-called historical costs. If there had been a writing off of the capital itself we would consider on the investment side that that investment account should not have been touched. You can write down this side if you like, but you should not change the historical record of costs, and you would have to put in what is called an adjustment figure to reconcile your original assets with the written down capital.

Q. Would not the position develop where even the existing shareholders would have lost quite a bit of their investment?

A. It could be so, but nevertheless I still think that under the present concept of railroad accounting that would not necessarily have reduced the investment in railway property.

Q. Would you have any percentage that you could put on that figure of \$804 million that would have been written off?

A. I say substantially all of it would have been converted into---

Q. Substantially all of it?

A. Yes.

MR O'DONNELL: Q. Converted into---

A. Into equity capital.



MR MACPHERSON: Q. And that equity capital of course is something that the railway might want a return on, a rate of return on, for its proprietors, from the freight payer of this country ultimately?

A. You see, when you convert debt into equity capital, even though there may be no prospect of a return on that equity capital, nevertheless, looking to the future of a country like Canada, there is always the possibility of the future bringing earning power to that property, which might in turn produce a return on the capital, and that is why if I were a security holder under a reorganization of that sort I would want some paper which would give me a chance to participate in any improvement which might result from the broader development of the economy of the country.

Q. But the point is, Mr. Cooper, that that money at its face value goes into equity capital?

A. Yes.

Q. Goes into equity capital?

A. Yes.

Q. And the proprietor in this case happens to be the nation?

A. Yes.

Q. And some day, as from the citizens of the nation, there may be a request for a return on that equity capital, one hundred per cent of it, where much of it ordinarily was lost?

A. Yes, it could be a return on a hundred per cent of the equity capital, but I think the right of return would be a balancing factor.

Q. You say a balancing factor; I suppose what you mean by that is that the regulatory body would keep the rate of return low because of the large amount of equity capital?





A. Precisely.

Q. Now, the second item there, \$100 million. Mr. Gordon said, at page 18381 of the record:

" . . . a great deal still remained to be done to take care of this situation on the lines of the Canadian Northern and the Grand Trunk Systems at the time of consolidation."

A. Where are you reading, please?

Q. I am reading from the record at page 18381.

THE CHAIRMAN: Something Mr. Gordon said?

MR MACPHERSON: Yes.

THE CHAIRMAN: He read the statement.

MR MACPHERSON: Yes.

THE CHAIRMAN: Can you refer to it?

MR MACPHERSON: I will get it in the statement too, Mr. Chairman. It is where he deals with \$100 million. It is at page 8 of the statement.

THE CHAIRMAN: "Run-down and semi-finished condition of properties taken over"?

MR MACPHERSON: That is right.

MR O'DONNELL: The figure is at the bottom of that page, my lord.

MR MACPHERSON: Q. He says there at the bottom of that page:

"It is a reasonable estimate that of this amount at least \$100,000,000 represented necessary improvements to the property which did not add to the earning power of the System."

Now, this was prior to 1923, Mr. Cooper?

A. The \$100 million?

Q. Yes.

A. No; subsequent to that.

Q. After 1923?

A. Yes.



Q. Now, as you told Mr. Covert this morning, the conditions of the road meant that of necessity there were abnormal sums spent on maintenance?

A. It seemed to me fairly obvious that that would be so.

THE CHAIRMAN: Abnormal sums spent on what?

MR MACPHERSON: Abnormal sums spent on maintenance, my lord.

THE WITNESS: And I said that was over the first decade.

MR MACPHERSON: Q. Over the first decade?

A. Yes.

Q. That would be up to 1933?

A. Yes.

Q. That in itself would be reflected again in your operating results?

A. Yes.

Q. Because the larger the sums you would pay for maintenance, charging to operating results, the greater would be your deficits in these years?

A. To the extent that we had this deferred maintenance.

Q. And that \$100 million again is reflected in this equity capital as you ultimately have it, because there was a capitalization of deficits?

A. No, sir. No, we are speaking of two different things. The \$100 million represents deferred improvements, if you like, which were properly chargeable to investment account. In addition there were deferred amounts of maintenance which were chargeable to operating expenses. I am speaking here when I speak of the \$100 million of those additions to the property which should have been made prior to 1923 which were made in the subsequent period and were added, and properly added, to the investment account. This



\$100 million had no effect on the operating results.

Q. Well, that \$100 million had no reference whatever to the abnormal maintenance that was done?

A. No.

Q. It was separate and apart from that altogether?

A. Yes, sir.

Q. But you would of necessity spend a great sum of money in this abnormal maintenance during that period of ten years?

A. Whether it was a great sum of money or not I do not know.

Q. You could not put a figure on it, Mr. Cooper?

A. I could not, no.

Q. But would that be reflected, the additional maintenance that you had to do, would that be reflected in this equity capital?

A. No, sir.

Q. In the larger deficits that you had?

A. No, sir.

Q. It was not represented at all?

A. Not at all.

Q. Then the next item on page 14, Mr. Cooper, co-ordination costs, \$290 million. Included in that is an item of \$40 million for main line connections, belt lines and terminal rearrangements?

A. Yes.

Q. Now, this was money that was expended by the C.N.R. on capital account for co-ordination?

A. Yes, subsequent to 1923.

Q. And this co-ordination would mean a considerable abandonment of old capital assets, would it not?

A. It would involve some retirement of capital assets, yes.





Q. And wouldn't it also involve certain maintenance expenditures charged to operating?

A. It should have resulted in reduced maintenance and operating costs.

Q. Beg pardon?

A. The effect of co-ordination should have reduced both maintenance and operating costs.

Q. And it was such an expenditure as would have been made by any business enterprise taking over and co-ordinating the system?

. I think so.

Q. I understand Mr. Fairweather is discussing negative capital?

A. Yes, sir.

Q. In the light of the questions you have answered already, Mr. Cooper, I do not think I need ask you about this, but just to clear it up: The proposed capital revision of the C.N.R. has nothing to do with the determination of a rate base at all?

A. No.

Q. And it is simply to reflect in equity capital that which will tie up with historical cost, reasonably?

A. It really is a transfer from funded debt to equity capital. It does not affect the investment account at all. It does not affect this record of historical costs in any manner.

Q. And the asset values shown in the balance sheet, in your opinion would they fall short or otherwise of reflecting historic costs and prudent investment, or could you say?

A. No, I could not answer that. If one takes into account appreciation as well as depreciation, I think it---

Q. Both ways?



A. .Yes.

Q. Now, according to your annual report, which is in evidence, there are a great many companies subsidiaries of the Canadian National now?

A. Yes.

Q. Do they serve any useful purpose, the great number of them that exist as they do?

A. If you notice, I read from the 1923 Annual Report, where Sir Henry Thornton said one of the things which the new administration would have to do would be to study the simplification of the corporation set-up of the Canadian National system.

(Page 18857 follows)



over the years we have not made a great deal of progress on that. When we can eliminate a company we do so, but new companies are constantly springing up and over the years I don't think we have made any sizeable reduction in the number of companies.

Q. Well, does there seem any useful purpose in keeping the 70,80 or 90 companies operating apart from the---

A. It is not from desire; it is of necessity. Let us take the example of the Canadian Northern. Why cannot that be consolidated with the Grand Trunk or the Canadian National? You see what I mean.

Q. Yes.

A. They have perpetual debenture stocks outstanding, and the consent of those debenture stock holders would be necessary for consolidation of Canadian Northern with Canadian National. Those debenture stockholders would not give their consent to an amalgamation unless we give them something. They say "Yes, if you will give us a Government guarantee" and we say we won't pay that price.

Q. Well, could not that all be taken care of by legislation protecting the rights of any debenture holders or bond holders that there may be in respect of their own securities?

A. Well, speaking personally on a matter of that sort, I would very much like to see legislation vesting these perpetual debenture stocks either in the name of the Canadian Government or Canadian National Railway Company. That was done in Great Britain during the war. They didn't hesitate too much. There may be a charge of confiscation, something of that sort, but if the consideration is equitable I don't think there would be very much in a claim of





that sort. But to me the idea that we can have these separate debenture stocks living in perpetuity, it is fantastic, and I think something should be done about it. But up to this point at any rate it has always been thought that it was a matter for mutual arrangement rather than by some vesting order. When you sit down to arrange these things by mutual arrangement, you generally find that the holders are trying to get something out of the railway which the railway is not prepared to pay.

Q. Well, this proposal of the fund of \$300. million is not to take care of that situation at all?

A. No sir.

Q. It is over and above the situation that was to be taken care of by the \$300 million fund?

A. There is nothing can touch these perpetuals except legislation.

Q. Now, Mr. Cooper, a few questions on your United States Lines?

A. Yes.

Q. Are they profitable?

A. I think as a broad answer the answer would be "yes".

Q. That they are profitable?

A. To the System.

Q. Profitable to the System in respect of the traffic they control for Canadian lines, I suppose?

A. The Grand Trunk Western is profitable in itself, and it is also profitable in the sense that it contributes traffic to the System. I would say the Central Vermont itself is not profitable; but if you put a valuation on its contribution to the System gross earnings and net earnings, I think that the studies which have been made



demonstrate that even the Central Vermont System is not unprofitable to the Canadian National System. But I suggest on that, if you wish to pursue it, that Mr. Fairweather is much better qualified than I am. It is a matter of research; it is not so much a matter of accounting. And I think you must have noticed that my effort in testifying has been to confine my testimony to the affairs of my own department.

Q. On hotels, have they been remunerative over the years, or has there been a reasonable return?

A. Well, again you have this question of usefulness to the System. The hotels as a rule were able to develop the traffic for the System. The record of our hotels for the last decade had been that they have made substantial net earnings, meaning revenues less expenses and taxes. If you were to set up an interest charge and a depreciation charge by themselves, that probably would show that they had not been operated at a profit, but again you have this intangible value to the System. Whenever I look at the Chateau Laurier and someone questions its success as a commercial venture, I cannot look at the Chateau Laurier in that sense.

Q. You regard it as part of the railway system?

A. I think not only is it part of the System: I think it is a national asset.

Q. Now, steamships, what investment do you have in steamships? Are they profitable or unprofitable?

A. Are you speaking of the West Indies Steamships? They are not owned by the System at all.

Q. Aren't they owned by the railways?

A. No, sir.

Q. They are not owned by the railways at all?



A. No.

MR MACPHERSON: I think most of the other questions I have would be for Mr. Fairweather in the light of the answers that Mr. Cooper gave.

THE CHAIRMAN: Does anybody else wish to question Mr. Cooper?

CROSS EXAMINATION BY MR FRAWLEY

Q. Mr. Cooper, I would like you to clear up for me the statement on page 15 of Mr. Gordon's statement with regard to this \$300 million. I don't know that I quite understand what that transaction will be.

A. Yesterday we filed a pro forma balance sheet which was intended to display it in an accounting sense. Is it a question on that?

MR. O'DONNELL: Exhibit 245.

MR FRAWLEY: Mr. O'Donnell says it is exhibit 245. I want to ask you two things about it and I think we could just discuss it generally.

A. Yes.

Q. What would it represent? In other words what is the principle behind it? Why do you think that the Government should acknowledge an indebtedness to you in the sum of \$300 million?

A. It is the only way that the President -- I won't say that -- it is a method which the President has advanced whereby interest on the funded debt held by the public---

Q. By the public, yes.

A. Might be reduced as far as the cost in interest to the railway is concerned. We have \$584 million of fixed charge debt in the hands of the public.





We think that is too high; we think that the railway cannot support that amount of debt; but we cannot touch those securities. So the introduction of this \$300 million whereby the Government would pay to us each year \$9 million, the \$9 million would have the effect of reducing the annual interest on the debts held by the public, that is to say, if the interest on the debt held by the public is \$23 million and we get \$9 million from the Government, then our interest is \$14 million.

Q. Then in simple language the Government is going to undertake to pay a part of the interest which you annually owe to the public.

A. Yes, but as the years go by and our public debt matures, it will be paid off out of the \$300 million, and if the operation of the fund was restricted entirely to funded debt in the hands of the public, in a matter of ten years at the outside the \$300 million would have been drawn down and the funded debt held by the public would have been reduced to that extent.

There was an alternative, of course, that the \$300 million might be used in part for capital expenditures and the effect of that is of course that instead of additions to the funded debt by the utilization of the fund itself the funded debt would be held down.

Q. In other words-- perhaps this is oversimplifying it -- suppose you took the \$300 million and just reduced the debt in the hands of the public by \$300 million. Then you would only have \$200 odd million.

A. That is so.

Q. Your fixed charges would automatically come down?



A. And this has that same effect.

Q. Now, why could not the Government simply wipe off \$300 million of what you pay the public?

A. You can't do it.

Q. That is the answer, you can't do it, because the holder has something to say about it?

A. Quite.

Q. And that is the answer perhaps. If they were different securities which you could pay off, perhaps that would be the simplest way to do it?

A. I would have been glad if I could have expressed it as concisely and correctly as you have done.

Q. Oh, Mr. Cooper.

THE CHAIRMAN: Mr. Frawley, has Mr. Cooper told us whether there is any force or any real meaning in the language used: "the Government should acknowledge an indebtedness"?

MR FRAWLEY: I was going to ask about that.

Q. What is that figure of speech? What does that mean, "acknowledge an indebtedness"?

A. Agree that this arrangement is satisfactory to them.

Q. I see.

THE CHAIRMAN: Well, you are inverting the language. What you really mean is this, isn't it, that you give the Government equity stock to the face value of \$300 million?

A. Yes.

Q. And they pay you back by giving you this \$300 million in another form?

A. Yes, but they would not pay us at once. They would only give it to us year by year.



Q. I know. Their indebtedness would consist of this \$300 million of equity stock which they were given?

A. They would have \$300 million of stock which they had not paid for.

MR FRAWLEY: Q. Coming back for a moment to the business of getting in these securities and redeeming them, and at the risk of saying something that is a little unorthodox, don't you think there is some field to be explored there to see if you could not get in some of these securities and pay them off?

A. Well, you saw what Sir Henry Drayton said in 1917 about this thing. That was the time to have done these things.

Q. It would sound like confiscation now, you mean?

A. Yes, it would.

Q. Some of these securities are carrying a pretty fair rate of interest?

A. They are.

Q. About what would be the highest?

A. Some of them are 5 per cent.

Q. You have not any sixes then?

A. I don't think so. We were fortunate that during the war the British Government vested all the railway securities which were owned by U.K. residents, and that has improved our picture quite a lot.

Q. But I mean, if you could do some refunding there is not any good reason why you should not. Do any of these securities admit of refunding?

A. Not these perpetuals, no.



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Q. There would have to be more drastic measures taken there, I suppose, by statute?

A. Yes.

THE CHAIRMAN: Are they all guaranteed by the Government?

A. Not all of them, my lord. Would you look at the Annual Report for 1948?

MR. O'DONNELL: It is Exhibit 217, my lord, at page 21.

THE CHAIRMAN: Q. Is there a large number not guaranteed?

A. There are four issues which are not guaranteed.

Q. What do they amount to?

A. They are shown in the fourth group there.

Q. I beg your pardon?

A. I say they are shown in the fourth group on page 21.

MR. O'DONNELL: Under the heading of "Other Issues".

THE WITNESS: There is 4% Perpetual Consolidated Debenture Stock, of the Canadian Northern, in the amount of \$3,992,929.66.

There is 4% Perpetual Consolidated Debenture Stock of the Canadian Northern Ontario in the amount of \$889,597.47.

There is 4% Perpetual Consolidated Debenture Stock of the Canadian Northern Quebec in the amount of \$465,545.33.

There is 4% First Mortgage Perpetual Debenture Stock of the Quebec and Lake St. John in the amount of \$285,342.40.



These are the perpetual securities which are not guaranteed.

Those which are guaranteed are shown at the top of the list. There are four issues there and they are all Grand Trunk issues. Two of them are 5%.

MR. O'DONNELL: Those are the ones at the top of the page.

THE WITNESS: Yes.

THE CHAIRMAN: Q. Are these perpetuals at the top of the page the only ones that are guaranteed?

A. Yes, sir.

Q. I see.

MR. FRAWLEY: Q. I take it that the reduction of fixed charges is a subject to which you have given a lot of thought over some years?

A. Since 1923.

Q. There you are. Now, is there anything at all on foot towards recalling any of these that are refunded?

A. If the terms of issue provide for call, we recall them.

For example, on page 21, about the thirteenth item down, you will see an issue of 5% 40 year guaranteed gold bonds issued in 1929 and maturing in 1969.

Q. Yes.

A. That was an issue in the sum of \$57,728,500.

Q. Yes.

A. And the terms of issue gave the railways the option to call these after 20 years. That is to say on October 1, 1949, which was last year, we had the right to call them at 105, and we did call them.

It cost us \$5 per \$100, which made a premium charge

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of \$2,886,425; and to finance that, we issued some bonds carrying coupons at 2-7/8, so there was a substantial saving there,

Q. Yes.

A. Now there is another issue there. I think it is the \$35 million issue, the next to the last. Excuse me, that is not the issue.

We called that issue of \$17,338,000.

Q. Yes.

A. They were 5% 40-year guaranteed gold bonds, and were issued on February 1, 1930. They were callable on February 1, 1950 at 105.

We have called them and we have paid the premium, and we have substituted an issue with 2-7/8% coupon.

Q. Yes.

A. And we have one or two more.

The next one which is callable is the Canadian National 3% 20-year guaranteed bonds due January 15, 1959. They are callable after January 15, 1954. They amount to \$35,000,000, and they are only 3% bonds.

What the situation might be in 1954, as to whether it would be advantageous to call them or not, I think we will just have to wait and see.

Q. Yes. And from what you have told me, I take it that you have been doing the best you can to reduce the fixed charges, the annual fixed charges?

A. There is no doubt of that.

Q. But it is because you feel you could not make very much progress very quickly that way, and because of the size of the problem, that you have worked out this scheme, whereby the Government will set up \$300 millions





and to pay you \$9 millions a year which you will use either to retire your interest-bearing obligations in the hands of the public, or for capital additions?

A. Yes.

Q. In gradual payments. That won't be enough. You do not expect that that \$9 million will be enough, do you, from year to year?

A. It is not the \$9 million, it is the \$300 million.

Q. Oh, you can use some of the \$300 million to pay interest with? You can do that?

A. No, sir. It is \$300 millions which, if this arrangement be approved, the Government has agreed to subscribe for additional equity stock in the Canadian National Railways, being the amount to be paid over to the railways as and when needed either for capital expenditures or for debt reduction.

MR. O'DONNELL: Q. You mean that now they pay 3%?

A. Yes.

MR. FRAWLEY: Turning now to a different subject, I take it you are generally in favour of uniformity of accounting?

THE CHAIRMAN: Before we leave that page, can we take it for granted that these equipment trust issues on page 21 are not guaranteed by any Government?

A. That is quite correct.

The first group is guaranteed by the Dominion of Canada.

The second group is guaranteed by the Province of British Columbia.

But the third group the Equipment Trust Issues are not guaranteed; and the other issues, in the fourth group



are not guaranteed either.

THE CHAIRMAN: Q. This \$19 million worth are not guaranteed?

A. It is more than that, sir. There are \$59,210,000 of Equipment Trust Issues, as well as \$32,585,151.46 of other issues which are not guaranteed.

COMMISSIONER ANGUS: Q. But the Equipment Trust Issues are secured?

A. Oh, yes.

MR. O'DONNELL: By the assets.

THE CHAIRMAN: Where are you going now?

MR. FRAWLEY: I am going to the question of uniformity of accounting.

MR. FRAWLEY: Q. Mr. Cooper, you subscribe to the desirability of uniform accounting for Canadian Railways?

A. If the question is put to us, the answer is yes. Our answer is yes.

Q. Do you regard uniformity of accounting as more important than the particular kind of accounting which might be followed, if I make myself clear?

THE CHAIRMAN: What page in the Brief is that to be found at?

MR. FRAWLEY: I was really following - -

THE CHAIRMAN: I want to know.

MR. FRAWLEY: I was following Mr. Gordon's statement. It is at page 17 of Mr. Gordon's statement, where Mr. Gordon says:-

"Our Company has submitted in respect to accounting that there should be a uniform system of accounts for Canadian Railways...."



THE WITNESS: Our position is this, that now the question is put to us - -

THE CHAIRMAN: What is that?

A. Our position is this, that now the question is put to us: Do you think there should be a uniform system of accounts for Canadian Railways? Then our duty says that our answer should be in the affirmative. But apart from that, we are perfectly satisfied to keep it as we are.

MR. FRAWLEY: Yes?

THE CHAIRMAN: Perhaps you are not quite so positive as Mr. Gordon's expression of it. Is it that there should be a uniform system of accounts for Canadian Railways?,

"...and that such system should be prescribed in accounting classifications to be issued by the Board of Transport Commissioners?"

MR. FRAWLEY: Q. Yes. And then the statement goes on and gives a reason for it, and says:-

"Comparisons of operating results and statistics do not stop at the international boundary."

That all seems to support the general proposition that there should be a uniform system of accounts.

A. That statement was made.

THE CHAIRMAN: And uniform statistical classification?

MR. FRAWLEY: Q. Yes.

A. That statement was made as if it were in answer to a question which had been put to the railways: What is your position in respect to the uniformity of accounting?





So the President says whatever words are there, that we believe there should be uniform accounting.

Q. I quite understand that the Canadian National did not institute this Commission. But one of the questions referred by the Governor-in-Council to the Commission - I have not got the terms here - is to inquire into the matter of uniformity of accounts.

A. Yes.

Q. And that being so, it is something which the Commission must report upon. So that is why I explore it with you, who are an experienced accountant, having been in charge of the accounts of the Canadian National on the highest level for all these years.

I want to know your opinion as to whether it would be good, or whether it should be required for Canadian railways that there should be uniformity of accounts?

A. My answer is: oh, yes.

Q. Now, going to the next phase of it: do you regard the need for uniformity as more important than which particular kind of accounting should be prescribed?

A. Yes, I will go along with that.

Q. Yes. And you feel that it has got to be committed to the Board as to which particular kind or method of accounting is selected and prescribed; that is, that is something which the Board must be left to do?

I agree with you.

Q. Do you say that there must be something in the Statute - unless there is something already there - requiring the Board to set up a uniform classification of accounts?

A. That is exactly as I see it.



Q. And you would stop there and leave the prescription of this or that method to the Board after hearing argument, or, rather after careful investigation?

A. Exactly.

Q. Now then, coming to the matter of rolling stock, you ' follow one method, while Canadian Pacific follows another?

A. Yes.

THE CHAIRMAN: That is, a method of depreciation?

MR. FRAWLEY: Q. Yes, a method of depreciation. And I take it, if called upon - no, perhaps you have sufficient faith in your system that you feel you should present to the Board your views as to why the straight line method should be adopted?

A. We are not afraid of taking our chances with the Board . We believe that we have a strong case.

Q. So it would not be a matter of sitting back and waiting to be asked. If the question of which system of depreciation should be used, you would be prepared to present your views as to the straight line method?

A. Yes.

Q. And you would abide by whatever prescription came from the Board after that consideration?

A. We would have to.

Q. When you come to roadways, you feel that there should not be depreciation accounting there at all?

A. Yes, sir.

Q. And the Canadian Pacific, of course, do follow depreciation accounting for depreciable road assets?

A. When you say "depreciable road assets", that again is a bit of a misunderstood phrase.

The first of these is the fact that the  
theory of the origin of life is still  
in its infancy. It is a subject which  
has attracted the attention of many  
of the most brilliant minds of the  
age.

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brilliant minds of the age.

When you speak of depreciable assets, what you really mean is "depreciable assets subject to depreciation accounting".

Q. Yes. That would be more exact.

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(page 18880 follows)





Q. That is more exact.

A. Because there are depreciable assets, for example, ties, rails. They are subject to physical depreciation but they are not subject to depreciation accounting.

Q. Just to recall it to my mind, under the I.C.C. are ties subject to depreciation accounting?

A. No, sir.

Q. And neither in Canada?

A. We have no prescribed accounting system in Canada.

Q. But in Canada neither yourselves nor the Canadian Pacific depreciate those rails and ties, and that sort of track material?

A. That is correct.

Q. So that it narrows itself down to what is commonly called, whether correctly or not, non-depreciable road assets that you say there should not be any depreciation accounting for and the Canadian Pacific does operate on a system of depreciation accounting? That is the situation?

A. For fixed assets other than track structure, fixed assets which are subject to depreciation accounting excluding track structure.

Q. You say as to them you do not depreciate. Your accounting is not depreciation accounting?

A. That is correct.

Q. And the Canadian Pacific has depreciation accounting?

A. That is correct.

Q. Coming to the new order of events that the Board will prescribe you would suggest that the Board should make -- you still adhere to the desirability for uniformity, do you not?

A. Yes, sir.

Q. So that you would seek to convince the Board in a helpful way that they should prescribe your method of dealing with these fixed roadway assets?



A. That would be our position with the Board, yes.

Q. And then if the Board prescribed depreciation accounting for those then you would go along?

A. Yes, but when you say "go along", depreciation accounting, of course, is based on the cost of the units of property which are subject to depreciation accounting. Now then, to institute depreciation accounting one must know the cost of the units that you are going to deal with. So we say we have no such inventory of units nor do we know their cost, and before we can adopt depreciation accounting, even if there were an order of the Board that it should be made effective, we say that until such time as we have an inventory of those assets we are not in a position to go along.

Q. That is one of the difficulties that would arise in your case if the Board prescribed depreciation accounting for these fixed roadway assets?

A. Yes. If I may, just in the interests of perfect frankness, I think that if it were agreed, as I mentioned yesterday, that the depreciation charge could be computed on some arbitrary rate on the book value of the assets it could be done on that basis but it is not depreciation accounting.

Q. These are all reasons why you think the Board should prescribe the method that you have been following?

A. Well, I went further than that. I did not take the position of being perfect. I suggested that the Board should consider the method which the British railways have adopted, and which is different from the practice we now follow. That, of course, as I explained is what is generally termed replacement accounting. If a unit of property is replaced in kind the British charge the cost of replacing it to expenses. There is no writing in or writing out of the unit





insofar as the investment account is concerned. If I might give a simple example of that, let us say we have a water tower that needs replacement. Let us say it cost us \$10,000 20 years ago. To replace it in kind let us say it would cost us \$16,000 at today's prices. Our present method is to write the existing unit out of the investment account and charge the \$10,000 to expenses, and to charge the investment account with \$16,000 representing the cost of the new unit installed today. The British would come along and say, "Replace that thing; don't touch your investment account, charge the cost of replacing it to operating expenses." They refuse to capitalize a change in the price level where units of property are merely replaced in kind.

If in the replacement you substitute an enlarged or improved unit of property then they would compute the difference between the cost of replacing in kind and the cost of the improvement, and the cost of replacing in kind is an operating expense and the cost of the improvement is an addition to the investment account.

COMMISSIONER ANGUS: Q. Under the British system might the expenditures of the railway be very variable from year to year?

A. Under the British system their expenditures would reflect the actual replacements and repairs made during that year.

Q. And there might be a great deal in one year and very little in another?

A. Well, I doubt that, Mr. Commissioner, because railways do not work with any violent fluctuations from year to year. They have steady programmes of maintenance and replacement. I think it is true that in times when they have buoyant revenues they probably spend more money on maintenance, and when times come hard like any other business they have to retrench.





THE CHAIRMAN: Q. Are you telling us now about the system adopted by the government administration of railways in England? Has it always been that way with the various companies?

A. I am not quite sure what the different railway companies did prior to nationalization.

Q. You are giving us the present system?

A. Yes, sir. This is the policy which the new British Transport Commission decided to follow with respect to roadway property.

COMMISSIONER ANGUS: Q. Would you allow deferred replacement in emergencies?

A. Sir?

Q. Would you allow deferred replacement in emergencies, allow them to put aside a sum of money because it could not be conveniently spent in the one year?

A. The British would do that.

MR. FRAWLEY: Q. I have a few questions about these unremunerative railways that are, as some of the public think, foisted upon the Canadian National from time to time. You told us that the Hudson's Bay Railway had had a period of entrustment to the Canadian National, and then that had been changed, and it now is operated by the government of Canada as the government of Canada?

A. Yes, except that the railway company act as agent or manager.

Q. You do the actual physical running of the trains and you charge a fee for your year's work?

A. For the management, but the actual revenues and the actual expenditures are charged to the government.

Q. Now, this may involve a matter of government policy, and if I am asking you a question you do not care to express an opinion upon you will say so, but personally I would value



your opinion as to the advisability of operating these unremunerative roads as a department of the government or as part of the Canadian National Railways?

A. Is that --

Q. I would like you to tell me what you think about that.

THE CHAIRMAN: Do you mean roads which are now called unremunerative?

MR. FRAWLEY: Yes, the Newfoundland Railway and the Temiscouata. Those two have been rolling off our tongues pretty freely lately. Take those two.

THE WITNESS: Well, expressing my personal opinion --

THE CHAIRMAN: Q. What is that?

A. Expressing more or less a personal opinion, because I am not authorized to speak for the railway in a matter of this sort, I consider the Canadian National Railway - that is the organization - is the servant of the state. Canada owns a number of railroads and Canada must have some agency, whether it is a department of government or the Canadian National organization, to operate the state-owned railways. In entrusting these properties to the Canadian National organization for management and operation we take the position, and we take it strongly, that that entrustment should be under terms which are equitable to the railway, and that we should not have a repetition of what happened in 1929 when these five railways that we speak of, which were taken over as a matter of public policy, were just pushed over on to the railway company. We had to assume the fixed charge debt with respect to the purchase price. We had to spend sizeable amounts of money for the rehabilitation of the lines, and we have had to stand operating deficits which resulted from that matter of government policy.

MR. FRAWLEY: Q. You say that has been bad on the morale of the rank and file?

A. I did not say that.





Q. Some people have said that?

A. Some people.

Q. Do you subscribe to that view in a broad sense?

A. Well, I do not feel very happy working for an organization which has the appearance of being a colossal failure.

Q. I was not getting up to you. I was going to deal with the effect on the rank and file, but even among the executives there is that natural feeling, I take it?

A. I think it is natural that any workmen would wish to work for a company which appears to be successful in its operations.

Q. Going back to the Hudson's Bay Railway, if they have an awfully bad year you do not feel badly about that. The railway as such doesn't care about that?

A. It doesn't affect us.

Q. That is one way of taking care of this morale situation, by not putting it in as a part of the system?

A. The thing has gone too far for that.

THE CHAIRMAN: Q. What is that?

A. I think the situation has gone too far to take these lines back again.

MR. FRAWLEY: Q. And other lines?

A. Yes, sir.

THE CHAIRMAN: Mr. Frawley, perhaps we had better take a few minutes recess.

---- Recess.

---- On resuming.

MR. FRAWLEY: Q. Mr. Cooper, I have not got the page reference but I made a note of something that you said yesterday. The note I made was that the Canadian National is expected to do many things that a private road would not have to do, or something to that effect. Do you recall saying that?

A. Yes.





Q. Just what did you mean by that? Will you expand upon that slightly?

A. We have to operate the Canadian government railways, the national trans-continental railway, such a thing as a drydock at Prince Rupert, the Newfoundland Railway, and these are the kinds of things which an ordinary commercial enterprise would not take over.

Q. You say an ordinary commercial enterprise would not take these things over?

A. Not without some sort of compensation.

Q. That is what Mr. Walker meant, I suppose, when I asked him whether his railway would have taken over the Temiscouata, and he said very plainly and bluntly --

THE CHAIRMAN: I beg your pardon. What is what?

MR. FRAWLEY: I was saying to the witness that Mr. Walker said, in answer to me, that his company would not have taken over the Temiscouata Railway.

Q. I take it that is the sort of thing you have in mind when you say that a publicly owned railway has to do things which a private road would not have to do.

THE CHAIRMAN: Q. Having regard to your lines now that you are now operating, what part of those lines do you consider to be just yourselves, and all the rest is taken on? You mentioned the National Trans-continental, for instance.

A. Oh, definitely I believe the whole thing is the national railway system.

Q. That is it, all your lines taken together are the system.

MR. FRAWLEY: Q. That is the situation in which you find yourself?

A. Yes.

THE CHAIRMAN: You asked Mr. Cooper about their obligation to take over certain lines whether they wanted them or not, and among those he enumerated in that class was the



National Trans-continental. Then they are all in that class.

MR. FRAWLEY: You have got a good deal of your mileage when you say that.

THE CHAIRMAN: I have not looked at their incorporation at all. What does it call for? There is a statute, is there not, incorporating the Canadian National Railways? Is that right?

MR. O'DONNELL: Pardon?

THE CHAIRMAN: There is a statute behind all this.

MR. O'DONNELL: Oh yes.

THE CHAIRMAN: What does the statute make the corporation to be, because we hear of them having to do this and having to do that. What are they themselves?

MR. O'DONNELL: The statute is Chapter 172 of the Revised Statutes of Canada, 1927, and I think the section that deals with the entrustment and management of these roads is Section 19.

THE CHAIRMAN: I mean it is an incorporation at the outset, is it?

MR. O'DONNELL: Yes.

THE CHAIRMAN: What does it say it shall be?

MR. O'DONNELL: It does not set it out quite as shortly as that. Section 3 sets out the provision that:

"The Governor in Council may nominate such persons as may be deemed expedient, not less than five, nor more than fifteen, to be directors of the Company hereby incorporated, and upon such nomination being made the persons so nominated, and their successors, and such other persons as may from time to time be nominated by the Governor in Council as directors, shall be and are hereby incorporated as a company, under the name of 'Canadian National Railway Company,' hereinafter called 'the Company'."





THE CHAIRMAN: Is there a section describing the assets of the company?

MR. O'DONNELL: Not as far as I remember, my lord.

THE CHAIRMAN: You see the point in my mind is that here is a company intended to operate railroads but then we are told "we are forced to do this and forced to do that." Where does the dividing line take place between what the company was originally intended to do and what was, as you might say, imposed upon it?

MR. O'DONNELL: Section 19 of the statute provides:

"The Governor in Council may from time to time by Order in Council entrust to the Company the management and operation of any lines of railway or parts thereof, and any property or works of whatsoever description, or interests therein, and any powers, rights or privileges over or with respect to any railways, properties or works, or interests therein, which may be from time to time vested in or owned, controlled or occupied by His Majesty, or such part or parts thereof, or rights or interests therein, as may be designated in any Order in Council, upon such terms and subject to such regulations and conditions as the Governor in Council may from time to time decide; such management and operation to continue during the pleasure of the Governor in Council and to be subject to termination or variation from time to time in whole or in part by the Governor in Council."

THE CHAIRMAN: You see what I am trying to get back to. Mr. Covert points out to me that the present position of the C.N.R. Company in relation to the C.N.





Railways is

(1) The C.N.R. Company owns the railways which were vested in the G.T.R. on January 30th, 1923, plus certain lines subsequently purchased or constructed by the C.N.R. Company;

(2) The C.N.R. Company manages and operates all Government Railways except the Hudson's Bay Railway;

(3) The C.N.R. Company controls by stock ownership all railways of other Companies of the C.N.R. system.

The C.N.R. may therefore be divided into three categories: (1) Railways owned by the C.N.R. Company; (2) Government Railways; (3) Railways of subsidiary companies of the C.N.R. Company.

MR. O'DONNELL: There is a whole array of orders in council. I have six or seven of them here.

THE CHAIRMAN: Pardon?

MR. O'DONNELL: There are a number of orders in council which tie in with that.

THE CHAIRMAN: I would like to know whether there is a real dividing line, whether the company can say "Here is our property and the other things we were made to do, and we preferably would not have done them." That is unremunerative lines, and so on. Then we have Mr. Gordon telling us that for the future they will not undertake to build any branch lines unless they want to foster-- does that mean the directorate there?

MR. O'DONNELL: Mr. Gordon says --

THE CHAIRMAN: He talks about future development lines which he says should be financed to the extent of not more than 60% by interest-bearing securities, and so on, the balance to be supplied by the government, and then he added a rider to that as follows:

" In saying what I have just said on this par-



"ticular point I would definitely wish to emphasize and make clear that there is no intention on the part of the Canadian National Railways to undertake the construction of any and all railways which might in the future be suggested, even if 40% of the capital were to be provided by way of equity stock. The Canadian National Railways should be free to consider on its own merits each individual case of developmental line which might be proposed in the future."

I raised that point yesterday to ask whether it was meant to include other lines that may be in existence now, provincial lines, or others which might be considered unremunerative. Is this attitude to be taken towards the acquisition of such lines in the future as well as to building new ones?

MR. O'DONNELL: As I understand it, the statute is there and under the statute the government may impose entrustment of these lines or any works covered by that. I think all Mr. Gorden is saying there, insofar as he and his board of directors are concerned, is that they would not want to have imposed on them the management of any and all lines even if the percentage of capital was to be provided concerning these future developmental lines as is set out.

(Page 18892 follows)





THE CHAIRMAN: Now, that goes to management. What does the entrustment section say? The entrustment section is the one---

MR O'DONNELL: Section 19, yes.

THE CHAIRMAN: How far does that go?

MR O'DONNELL: It goes very far. It says:

"The Governor in Council may from time to time by Order in Council entrust to the Company the management and operation of any lines of railway or parts thereof, and any property or works of whatsoever description, or interests therein, and any powers, rights or privileges over or with respect to any railways, properties or works, or interests therein, which may be from time to time vested in or owned, controlled or occupied by His Majesty, or such part or parts thereof, or rights or interests therein, as may be designated in any Order in Council, upon such terms and subject to such regulations and conditions as the Governor in Council may from time to time decide; such management and operation to continue during the pleasure of the Governor in Council and to be subject to termination or variation from time to time in whole or in part by the Governor in Council."

THE CHAIRMAN: That would seem to refer, though, only to lines which come into existence outside of the railway; is that right?

MR O'DONNELL: I think that is right, yes.

THE CHAIRMAN: Nothing to do with building new lines.

MR O'DONNELL: No; and, as Mr. Gordon stated, restricted to future development lines.

THE CHAIRMAN: To give me an understanding of that, with regard to the present position of the Hudson Bay Rail-





way, is that a line which now is under entrustment, or is it outside of entrustment under that section? Perhaps Mr. Cooper---

MR O'DONNELL: Well, the situation there has changed, as Mr. Cooper said; it has varied from time to time.

THE CHAIRMAN: What is it now?

MR O'DONNELL: As I understand it now, the Hudson Bay Railway is owned by the Government and is managed by the Canadian National Railways for the account of the Government, the profit or the loss being the Government's.

THE CHAIRMAN: On what terms?

MR O'DONNELL: Q. Isn't that the condition, Mr. Cooper?

A. Yes. It has not been entrusted in the sense that entrustment is meant in that section. We have been appointed a manager, but the railway has not been entrusted---

THE CHAIRMAN: Of course, the section is very wide. It says entrustment may be on any such terms---

MR O'DONNELL: I think in the record in this case a copy of the Order in Council covering the situation so far as the Hudson Bay Railway was concerned was filed out in the west, in Winnipeg or one of those places, and I will be glad to look it up.

THE CHAIRMAN: The point is, we would like to know the scope of that section which you have read, the entrustment section, and if we have the exact position today of the Hudson Bay Railway it would illustrate it.

MR O'DONNELL: I will look up the Order in Council, my lord.

MR FRAWLEY: Yes.

Q. It might be, Mr. Cooper, that in one manner of



speaking the Hudson Bay Railway is presently entrusted to the Canadian National?

A. No, sir.

Q. In no sense of the word at all?

A. No.

Q. Because of the particular meaning that you attach to the word "entrust"?

A. Yes, sir, that is correct.

THE CHAIRMAN: That, you see, brings in an interpretation of the section.

MR FRAWLEY: Of the statute, that is true -- which we can do here.

Q. I was going to ask you about the Newfoundland and the Temiscouata; you say you had nothing to do with the entrustment of the Temiscouata?

A. No.

Q. And you won't have anything to do with the entrustment of any other road which the Government of Canada might see fit to act upon in the future?

A. Well, Mr. Donald Gordon thinks he will.

Q. He thinks he will? Well, that is what Mr. Gordon meant when he made the statement here the other day?

A. Yes.

Q. He thinks there will be some resistance, perhaps?

A. Yes.

Q. But Parliament of course has given the Governor General in Council power to entrust to your railway any railway it likes?

A. Right.

Q. It might be the P. G. & E. tomorrow; it might be under, as far as Parliamentary authority is concerned?

A. Conceivably.

THE CHAIRMAN: Well, we have to be very careful in



considering these things put before us, because here is a statute. It may in some cases mean an alteration in the statute itself.

MR FRAWLEY: Yes.

MR O'DONNELL: My lord, I have the Order in Council. It was produced as Exhibit 14, and it is Order in Council P.C. 3340, the 27th day of July, 1948. I do not know whether your lordship would like to have me---

THE CHAIRMAN: It is just an Order in Council directing the railway to do certain things, is it?

MR O'DONNELL: It goes on to say:

"WHEREAS the Minister of Transport reports:

"THAT by Order in Council P.C. 115 of 20th January, 1923, the Hudson Bay Railway (hereinafter called the 'Railway'), which is included in the properties known as the Canadian Government Railways, was entrusted to the Canadian National Railway Company (hereinafter called the 'Company') for management and operation;

THAT by Order in Council P.C. 974 of 25th June, 1926, the management and operation of the Railway was terminated and withdrawn from the Company, pending completion of the works of construction and betterment of the Railway;

THAT the construction of the Railway has been substantially completed and the Railway has been and is being operated for the Department of Transport by the Company under separate appropriations provided annually by Parliament for deficit and capital purposes;

THAT in order that the tariffs of the Railway and the conditions of operation of the Railway shall continue to compare favourably with those of other railways which are subject to the provisions of the





Railway Act and the jurisdiction of the Board of Transport Commissioners, it is considered advisable to re-entrust to the Canadian National Railway Company the operation and management of the Hudson Bay Railway, subject to the conditions that the budgeting and the accounts of the Railway shall not be included with those of the Company;"

THE CHAIRMAN: Those were the conditions.

MR O'DONNELL: Yes. Then it goes on:

"THAT, in the circumstances, the Company will have certain equipment which may be utilized and certain employees who may be employed in the execution from time to time of works of addition and betterment, maintenance and operation of the Railway;"

THE CHAIRMAN: I have no doubt that Order in Council was passed under the authority of the statute.

MR O'DONNELL: It says:

"NOW, THEREFORE, His Excellency the Governor General in Council, on the recommendation of the Minister of Transport and pursuant to the provisions of section 19 of the Canadian Railways Act, Revised Statutes of Canada, 1927, chapter 172, is pleased to order and doth hereby order . . ."

THE CHAIRMAN: Now, if the Canadian National Railways think that any of the objects they are pursuing before us require an amendment to that statute, we would like to know.

MR O'DONNELL: Yes. I think---

THE CHAIRMAN: You see the point.

MR O'DONNELL: I see the point, my lord, and I think all Mr. Gordon was saying was now putting people who may be concerned on notice that he does not intend, as far as he has any way of avoiding it, to be saddled with a lot



of unremunerative roads, future development lines, on terms that might not be satisfactory. I think he is just trying to keep his lines open so he can object. But how far that would go without an amendment to the statute I do not know.

THE CHAIRMAN: The language is pretty definite -- no intention to undertake, and so on. Well, if you think it is worth while to pursue the matter, I would advise you to look into your statute and see as to amendments.

MR FRAWLEY: Q. Mr. Cooper, a gentleman appeared before the Commission some weeks ago and sought the re-commendation of the Commissioners for the extension of the Canadian National from a place called Barraute into the Quebec hinterland someplace, and he told me that if it had been the Canadian Pacific that had been at Barraute he would not have thought for a moment of asking it to extend the line, but this was the Canadian National Railway Company, this was entreprise publique to him, and that was his justification for asking the Canadian National to build this road. Now, what do you think about that situation? Do you think there is a feeling abroad that the Canadian National is there as servants to the public, to build these pioneer roads wherever the settlers think they should go?

A. No, I do not think so. You cannot prevent the odd fellow from coming up and making a suggestion of that sort.

Q. You would be surprised if that road were built, I suppose, would you?

A. I would -- well, I perhaps should not have said that. Mr. Fairweather is the one to answer that question. I would be surprised myself.

Q. But it seems to me there is this distinction between what can be expected of the Canadian Pacific and what can be expected fairly of the Canadian National; that is what dis-



turbs me.

A. Yes, but because a person comes and makes a request of that sort, it does not indicate that he expects it will be done or that it will be done or anything of that sort.

Q. Well, Mr. Walker told us that if anybody had asked him to take over the Temiscouata he would have just said No; but the Canadian National had it entrusted to it?

A. That is right.

Q. By the Minister of Transport?

A. By the Governor in Council.

Q. By the Governor in Council, yes. So there is a distinction there as to the -- what shall I say? The power to resist of the two railways?

A. There is a distinction.

Q. Yes. Now, what is troubling me, Mr. Cooper is, if you are in that position and you are liable under that statute to have unremunerative roads entrusted to you like that from time to time, and completely entrusted, not as in the case of the Hudson Bay, where you are not responsible for the deficits, if you have to have these roads, or at least are exposed to having them entrusted to you, how can you expect to be the guide or measure for the fixing of freight rates in Canada?

MR O'DONNELL: We have not asked that.

MR FRAWLEY: I have heard your answer, Mr. O'Donnell; I would like to have one from Mr. Cooper.

THE WITNESS: I would have to repeat that. We have not as far as I know, and it is quite outside my scope in any event.

MR FRAWLEY: Q. To be made the yardstick?

A. I am not concerned with the matter of the yardstick in any degree.





Q. That is true. And all of these matters -- let me put it to you this way -- all of these matters with regard to the rehabilitation of the Canadian National are perhaps only of importance to yourselves and your owners, and of no importance to the freight shippers of Alberta that I represent, unless rates are to be fixed using the Canadian National as the guide or measure; that is about right, isn't it?

A. I cannot see it.

Q. You cannot see that it matters to us?

A. No.

Q. That is right. Now, let us have agreement on that. So I need not concern myself, acting for the freight shippers and the kind of freight rates they have to pay, with any of this New Deal Canadian National that we have heard about; that is a matter between yourselves and your owners, and you do not expect that to be reflected in any way in the freight rate structure; is that so?

A. That would be my expectation.

Q. Because I suppose it is not unfair -- or you tell me if it is -- is it unfair to say that if this new Canadian National which will emerge was to be used as the measure or guide for freight rates, it would be pretty hard on the Canadian Pacific, wouldn't it?

A. Well, of course, now you are getting me into this yardstick business, and I am not really concerned with it at all, and I do not think you should press me on it.

Q. I won't.

MR O'DONNELL: That is for another day.

MR FRAWLEY: I won't.

THE CHAIRMAN: Just a last word, Mr. O'Donnell, about that statute. I suppose it provides somewhere for the building of new lines, does it?



MR O'DONNELL: I am frank to say at the moment I have not looked at it, but I will be glad to. I think section 21, if I remember rightly, is the section. Yes, it is. In the marginal note:

"Power to construct and operate railway lines."  
And the section reads:

"21. With the approval of the Governor in Council and upon any location sanctioned by the Minister of Railways and Canals the Company may from time to time construct and operate railway lines, branches and extensions, or railway facilities or properties of any description in respect to the construction whereof respectively, Parliament may hereafter authorize the necessary expenditure, or the guarantee of an issue of the Company's securities."

THE CHAIRMAN: That would seem to leave the initiation to the company.

MR O'DONNELL: "2. A copy of any plan and profile made in respect of any completed railway shall be deposited with the Board of Railway Commissioners for Canada."

That is the section under which we have to go to Parliament.

THE CHAIRMAN: You have first to get the approval of the Cabinet.

MR O'DONNELL: That is right, my lord.

THE CHAIRMAN: Apparently the idea would originate with the company.

MR O'DONNELL: Yes, I think the company can initiate under that section, and with the approval of the Governor in Council, upon any location which is sanctioned by the Minister, the company may proceed from time to time to construct and operate, and Parliament has to authorize the necessary expenditure.



MR FRAWLEY: Q. Now, Mr. Cooper, I have only one more kind of question -- just one or two questions. Would you mind looking at page 15 of your 1948 report, Exhibit 217?

A. Yes.

Q. Now, under the heading of "Operating Revenues" there, you show telegraph, commercial telegraph; you show an item there---

THE CHAIRMAN: Pardon me. What is your reference to?

MR FRAWLEY: Page 15 of the 1948 Annual Report.

Q. And you have taken in as operating revenues, that is, operating rail revenues, of course, isn't it, Mr. Cooper?

A. Yes.

Q. Seven million eight; that was the result of your operation of your commercial telegraph system in 1948?

A. Yes.

Q. Why do you take that into rail revenues, Mr. Cooper?

A. We consider our telegraph department is another department of our railway system, and from the beginning in 1923 we have always looked on the earnings and expenses of that department as part of our rail system operations.

Q. Now, you know the Canadian Pacific treat it quite differently?

A. I understand so, yes.

Q. Well, you know that from an examination of their Annual Report?

A. Yes.

Q. Now, has that matter ever been discussed at all between the two railways, as to what should be matters such as that, taking that item of telegraph, whether that should





be included as rail or non-rail income in the company's operating revenues?

A. Yes, it has been discussed.

Q. It has been discussed?

A. Yes.

Q. What was the nature of the discussion? A specially called conference or---

A. It was part of the committee that was established in 1936 by the Minister of Transport to endeavour to draw up a uniform system of accounts for railways.

Q. And it did not get to any more than a discussion, I suppose?

A. Oh, yes.

MR O'DONNELL: It is referred to on page 86 of the brief.

THE WITNESS: We discussed this thing for two or three years.

MR FRAWLEY: Q. Well, was it from the standpoint of one endeavouring to persuade the other, or was it just an exchange of views and a----

A. No, we made a serious effort to draw up a Canadian classification. We had instructions from the Minister of Transport to endeavour to do that.

Q. Now, you speak of a Canadian classification, and perhaps I am not just sufficiently appreciative of how you use that word. They earn so much money from their commercial telegraph enterprise, and they put that into non-rail, or, as it is called, other income. You put it into rail income. Now, getting away from the mere matter of accounting, there is a principle there of whether that should be properly regarded as rail revenue or non-rail revenue. Now, did your discussions go to the principle of it, as to whether it should be rail or non-rail revenue?



A. They did.

Q. And no conclusion was reached?

A. No, no definite conclusion was reached, but I will be frank to say this much, that I said if the Canadian Pacific would agree to put their express revenues and expenses in rail line operations I would meet them on commercial telegraph operations.

Q. You would put your telegraph operations into non-rail?

A. Yes.

Q. If they would put their express revenues into rail?

A. Yes.

Q. Well, but, Mr. Cooper, you are aware, aren't you, that they are now putting their express revenues into rail, with the exception of what they make on the financial side of the business?

A. I do not quite agree with that.

Q. Well, why don't you? You have another interpretation of that, have you?

A. They put in their net revenue.

Q. Their net revenues, yes.

A. A different thing.

Q. And that is a different thing?

A. Yes.

Q. So, in other words, it was a sort of exchange; if they would come uniform with you on express you would go uniform with them on telegraphs?

A. We were prepared to go so far in order to arrive at something that was agreeable to both.

Q. Now, that is very interesting. Is it so indifferent as to whether it should go into rail or non-rail as that?

A. In my opinion we are correct on both counts, both express and commercial telegraphs.



MR O'DONNELL: And that is the opinion of Mr. Liddy, so far as he is concerned.

THE WITNESS: Sir?

MR O'DONNELL: That is the opinion of Mr. Liddy, so far as he is concerned.

THE WITNESS: I see.

MR FRAWLEY: Q. Now, not having been able to accomplish anything there, will you just put on the record for the information of the Commissioners why you think your commercial telegraph operation should be in rail income, where you have it?

A. I have done that.

Q. Well, if you just refer me to that, then we won't take too long about it.

MR O'DONNELL: Page 98.

(Page 18906 follows)





MR. O'DONNELL: Page 98.

THE WITNESS: Yes . Our position is set out at page 98 of our main submission.

MR. FRAWLEY: Thank you very much, Mr. Cooper.

THE CHAIRMAN: What page is that?

THE WITNESS: Page 98.

MR. FRAWLEY: Q. Where do you have your hotel revenues?

A. They are excluded from rail line revenues and expenditures. They are shown in our income accounts. If you will look at page 4 of our 1948 Annual Report.

MR. O'DONNELL: That is Exhibit 217.

MR. FRAWLEY: Q. That comes into your "Other Income"?

A. Yes.

Q. Why do you put "Hotels" into "Other Income", and not into "Rail"?

A. We do not consider it is rail revenue.

Q. That is obvious. But why do you not?

A. Well, providing board and lodgings for people hardly seems to be direct rail transportation, does it. Does it?

Q. You do not think it is integrated with "Rail" sufficiently that the revenue should go into "Rail"?

A. It is integrated into the National Railway System and it forms part of our System Income Statement.

Q. Let us not spend too much time on it, because Alberta thinks it should be in "Non-rail" too.

What about the Toronto Terminals Railway? Where do you put your revenues from the whole operation of the Toronto Terminals Railway? Do you put that into "Rail" or "Non-rail"?

The first part of the paper is devoted to a general discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The second part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The third part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The fourth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The fifth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The sixth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The seventh part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The eighth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The ninth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom. The tenth part is devoted to a detailed discussion of the problem. It is shown that the problem is of great importance in the theory of the structure of the atom.

A. Well, I would consider it is all in "Rail", if you should make a separation of our Income account as between "Rail" and "Non-Rail", but we have not made it.

Q. If you did make it, where would you put it?

A. I would put Toronto Terminals Railway all in "Rail".

Q. It does not cease to be a railway because you have to operate it jointly with another railway?

A. If you have in mind the interest we receive from the Toronto Terminals Railway, that it should be shown as "Non-rail" revenue?

Q. At the moment I think it is shown as "Non-rail" revenue.

A. I would not agree with that.

Q. Do you see any distinction, an essential distinction between the operation of the Toronto Terminals and the operation of any terminal which you operate solely, such as your terminal at Winnipeg, for instance?

A. Not in the end result, no.

MR. FRAWLEY: That is all I have. Thank you, Mr. Cooper.

MR. COOPER: Thank you.

CROSS-EXAMINATION BY MR. SHEPARD

MR. SHEPARD: I have a few questions to ask, my lord.

THE CHAIRMAN: All right. Go on.

MR. SHEPARD: Q. My questions have to do with two points, Mr. Cooper.

I want to bring to your attention, if I may, what the Manitoba Submission has to say, first of all, with



regard to this matter of the Canadian National Railways not being used as the yardstick.

I have listened to what you said already on this matter; but inasmuch as Mr. O'Donnell has stated the views of the Canadian National that they are not putting forward this suggestion as to capital revision with any thought in mind of the Canadian National replacing the Canadian Pacific as the yardstick for rate-making, I thought it would be useful if you would listen to two or three reasons to be found at pages 68 and 69 of the printed copy of the Manitoba Brief.

MR. O'DONNELL: I do not think I quite put it that way. However, the record will speak for itself.

MR. SHEPARD: Q. Starting first at page 67, we deal with : "The Place of the C.N.R. in the Making of Freight Rates". That is the heading.

Then, over on page 68, we say:-

"In the past the practice in Canada has been to use the results of the C.P.R. as the yardstick for determining rate level cases. The reasons for omitting the C.N.R. from such consideration have been stated at length in a number of arguments and decisions over the past 30 years.

The first reason is the fact that the capital structure of the C.N.R. based as it is upon a reorganization of a number of bankrupt or near bankrupt lines is such that its fixed charges are far in excess of those for comparable railways on the North American continent."





I presume you would agree with that as a reason?

A. A reason for what?

Q. For not using the Canadian National as a yardstick for rate-making.

A. It seems to me that one by one you are trying to break down my resistance for not getting into this matter of the yardstick.

(Page 18910 follows)



Q. I appreciate that you are being very careful to classify yourself only as an accountant, but you are also a senior executive of the C.N.R., and I would assume in that capacity that you might have opinions on something other than strictly bookkeeping.

A. No, sir, in that I think you are mistaken. The Canadian National Railway is a fairly big organization.

Q. Yes, I appreciate that.

A. It is true I am a vice-president. My affairs are related to my own department and I would not consider the matter of rate-making as coming into my jurisdiction in any shape or form.

Q. So you would prefer that I would not ask you for your agreement or disagreement on any of these matters dealing with the yard-stick question ?

A. I would prefer that.

Q. Can you tell me who I should ask?

A. Perhaps you had better ask the counsel.

MR SHEPARD: Will there be a witness available?

MR O'DONNELL: I haven't any idea. We have Mr. Fairweather available.

MR SHEPARD: I wonder if he will answer the question, or perhaps that is not in his department either.

MR O'DONNELL: I don't know. He will be here and you will ask him. After all the formal position of the Company is set out in its brief and set out in the submission of Mr. Gordon, the President, made with the approval of the Board of Directors. That is the position at this point.

MR SHEPARD: I take it from that Mr. Chairman, that Mr. O'Donnell says that the statement is there and it is to be interpreted as we see fit.



THE CHAIRMAN: What precise statement have you in mind?

MR SHEPARD: Only the statement that Mr. O'Donnell put on record this morning.

THE CHAIRMAN: There is nothing in the brief or Mr. Gordon's statement as I recollect it.

MR SHEPARD: No, there is not.

THE CHAIRMAN: Mr. O'Donnell is speaking for the Company.

MR SHEPARD: Yes, it does seem a bit odd to me, with all due respect to the C.N.R., that questions of this kind cannot be discussed.

THE CHAIRMAN: They are not saying---

MR O'DONNELL: We don't say---

THE CHAIRMAN: We are not saying they cannot be discussed when you have the proper witness. We are told Mr. Fairweather is the chap.

MR SHEPARD: Do I take that as being so, Mr. O'Donnell?

THE CHAIRMAN: You want to ask him why that is the attitude of the Company?

MR SHEPARD: I wanted to explore that with some witness/whoever would like to discuss it.

MR O'DONNELL: Mr. Fairweather, as has been said, is the gentleman who would speak to a number of matters in Mr. Gordon's statement which Mr. Cooper did not cover. I think Mr. Fairweather can answer the questions.

THE CHAIRMAN: I understand the position to be this. You have said your Company is not asking to be made the yardstick for---

MR O'DONNELL: I have just said with respect to the submission before the Commission, that they are not





requesting that we be made the yardstick.

THE CHAIRMAN: Who is going to answer questions about your reason for taking---

MR O'DONNELL: I think Mr. Fairweather can answer this.

MR SHEPARD: That's fine.

MR O'DONNELL: One thing at a time.

MR SHEPARD: I agree. Two at a time gets complicated.

Q. Mr. Cooper, the only other point I want to discuss with you (and I am not sure I can discuss this one with you either) is that at page 15 of Mr Donald Gordon's statement, item (2), reference <sup>is</sup> made to this \$300 million sum which my friend Mr. Frawley has already discussed with you to some extent this afternoon.

A. Yes.

Q. Now, I notice that in the second sentence in that paragraph 2 it indicates that the monies would be used either to retire interest-bearing obligations in the hands of the public or for capital additions to the property. I presume that one reason why you are making that suggestion is that it would be impossible for the C. .R. to go out and acquire equity capital in the open market?

A. Oh, I think it is quite contrary to Government policy that there should be any outside stock control of Canadian National Railways .

Q. Yes, under any terms of issue.

A. I think the statute incorporating the Canadian National Railway Company requires that the stock should be owned by the Government of Canada.

Q. That is, the statute in its present form.

A. Yes.



~~with~~ Q. But I presume you are familiar, Mr. Cooper, with the difficulties that railways generally, privately owned railways, have had in obtaining equity in recent years.

A. I understand that is the general situation.

Q. And that the majority of them, including the C.P.R. cannot raise new capital by issuing common stock because their stock is selling below par.

A. I understand that is one of the reasons.

Q. All I wanted to ask you was this. If the C.P.R. should demonstrate a need similar to the C.N.R. for equity capital, would you consider it unreasonable for the Government to deal with them in the same manner that you are now suggesting they should deal with you?

A. That would be a matter for the Government to decide. There would be no objection on my part to the Government of Canada buying stock in the Canadian Pacific Railway.

Q. But you did mention that there was some precedent for this during the 1930's from the public works standpoint?

A. Not in buying stock, no.

Q. Not in buying stock, but perhaps we could draw some analogy to it that the Government did advance monies and paid the railways for public works purposes.

A. For relief purposes.

MR O'DONNELL: We asked them to supply the money to give the employment.

MR SHEPARD: Q. But you would agree that if perhaps the C.N.R. was given the concession, it would not be unreasonable for the C.P.R. to be given the same type of concession.

A. I would agree with that.

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COMMISSIONER ANGUS: Well, are we quite prepared for the yardstick railway to be subsidized? It indirectly affects the ratio you get.

A. If the Government of Canada want to give money to the Canadian Pacific Railway it is none of my business I am sure of that.

Q. That is all Mr. Cooper.

THE CHAIRMAN: We will resume tomorrow morning.

---The Commission adjourned at 4.50 p.m., to meet again at 10;30 a.m. on Thursday, March 23, 1950.





*Cause No. 102*  
ROYAL COMMISSION  
ON  
TRANSPORTATION

EVIDENCE HEARD ON

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ROYAL COMMISSION ON TRANSPORTATION

Thursday, March 23, 1950

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO  
THURSDAY  
MARCH 23, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN  
HAROLD ADAMS INNIS - COMMISSIONER  
HENRY FORBES ANGUS - COMMISSIONER

-----  
G.R. Hunter  
Secretary

P.L. Belcourt  
Asst. Secretary  
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COUNSEL APPEARING:-

F.M. Covert, K.C.	}	Royal Commission on Transportation
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H.E. O'Donnell, K.C.	}	Canadian National Railways
N.J. MacMillan		
H.C. Friel, K.C.		
C.F.H. Carson, K.C.	}	Canadian Pacific Railway
F.C.S. Evans, K.C.		
I.D. Sinclair		
C.D. Shepard	)	Province of Manitoba
M.A. MacPherson, K.C.	)	Province of Saskatchewan
J.J. Frewley, K.C.	)	Province of Alberta
F.D. Smith, K.C.	}	Province of Nova Scotia; Transportation Commission of the Maritime Board of Trade.

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Ottawa, Ontario,  
Thursday, March 23, 1950.

MORNING SESSION

T. H. COOPER, Recalled

THE CHAIRMAN: All right, Mr. Evans.

MR O'DONNELL: May it please the Commission:

Dr. Innis asked the other day if we would prepare a tabulation of the unmatured public debt held by the public, showing the date of maturity in each case. We have done that, and we will produce it as Exhibit 252. It is entitled "Unmatured funded debt held by the public, showing the date of maturities," the same as the table which was produced the other day, with that additional column.

---EXHIBIT 252: Statement - Unmatured funded debt held by public, showing date of maturities.

MR EVANS: Before I begin, I have an exhibit to file, in response to a request made by Mr. Covert yesterday. It corresponds to the exhibit which he asked the Canadian National to file. It will be Exhibit 253.

THE CHAIRMAN: I beg your pardon?

MR EVANS: I was about to say, my lord, that Mr. Covert asked us yesterday to file with the Commission an exhibit corresponding to that filed by the Canadian National at his request, showing the revenue which would have been received had the various increases which we have had in freight rates been effective one month after the application rather than the dates on which they were in fact effective. That will be Exhibit 253.

-- EXHIBIT No.253: C.P.R.Company - Estimated revenue accruing had rate increases become effective one month subsequent to date of application.



CROSS-EXAMINED BY MR EVANS:

Q. Now, Mr. Cooper, before I begin my cross-examination I want to get on this basis with you, that the Canadian Pacific are not taking the position that they are opposed to your getting such relief as you may be able to establish is necessary and proper. What we are concerned with is to see that the nature of the relief and the conditions under which it is granted, if it is granted, will not place the Canadian Pacific in jeopardy. Now, with that basic approach, I begin by referring you to Mr. Gordon's statement at page 18371.

COMMISSIONER INNIS: Do you know the page on the statement, Mr. Evans?

MR EVANS: The page on the statement I am afraid I have not got. I thought it would probably be better to have it on the transcript.

MR CARSON: Page 2.

MR EVANS: Yes, page 2.

Q. About the beginning of the second complete paragraph on page 2 these words appear:

"The importance of the railways in the national transportation field cannot be exaggerated. They are of prime importance from the viewpoint of national development and national defence. Anything which weakens or affects their ability to operate and maintain their properties efficiently, weakens the country generally."

Now, I assume that you agree entirely with that statement, Mr. Cooper?

A. Those, of course, are the President's views. I agree with them completely.

Q. Now then, I think it quite clear from the way in which the President put his statement that what he had in



mind was that what was true of the Canadian National in that respect was also true of the Canadian Pacific in that respect -- that is to say, that their importance in the national transportation field cannot be exaggerated?

A. He is speaking of the railways of Canada, not of the Canadian National, so I have no doubt he includes both railways.

Q. Well, I would have thought so, yes. Now then, just to get this clear, it is my understanding from that statement that in effect the position of the Canadian National is that the importance of the Canadian Pacific in the national transportation field cannot be exaggerated. Could we get to that common basis to start with?

A. Cannot be exaggerated?

Q. Yes; I am using Mr. Gordon's words.

A. Oh, I see.

Q. Cannot be exaggerated?

A. Yes.

Q. Now then, as a necessary corollary to that -- or I think perhaps I should say a necessary sequence to that thought -- would you not agree that anything which weakens or affects the ability of the Canadian Pacific to operate and maintain its railway properties and to serve Canada would, to use the words of Mr. Gordon, weaken the country generally?

A. I would agree with that.

Q. Now, as a further step, the position of the Canadian Pacific, or for that matter any privately-owned railway, would be weakened if it were compelled to provide a service at lower than a reasonable return on its investment, whatever that may be, whatever the Board may decide that may be?

A. Do you mind repeating that?





Q. That the position of a privately-owned railway company, the Canadian Pacific or for that matter any privately-owned railway, would be weakened if it were compelled to provide railway service at less than what would be a fair return, whatever that may be decided to be?

A. That again seems to be getting back into this question of rate of return and the yardstick, and---

THE CHAIRMAN: You did not say a fair return on what.

MR EVANS: Well, a fair return on its investment, whatever the investment may be found to be or whatever the return may be found to be. I am only speaking in generalities.

THE WITNESS: I see. Well, I would agree with that, because I know that is the policy generally followed in the United States, and it seems to me to be logical, and I would be inclined to agree with your statement.

Q. Now, as a further step in this preliminary discussion, would it be fair to ask you this, whether you do not also agree that it is desirable to maintain the Canadian Pacific as a healthy and sound private enterprise competing with the railway system of the Canadian National?

A. In my personal opinion, yes, definitely.

Q. Do you differentiate between your personal opinion and your official opinion as an officer of the Canadian National?

A. Not on that question.

THE CHAIRMAN: Q. That is, you know, do you, that what you are saying expresses the views of the Canadian National Railways?

A. No, sir. I said that personally and as an officer of the company, I would agree with that statement.



MR EVANS: Q. But you prefer not to say that that is the official position of the Canadian National?

A. No, I could not speak for the top policy of the Canadian National.

(Page 18920 follows)



THE CHAIRMAN: Mr. O'Donnell, how do you intend to inform us with more authority about the views of the Canadian National as an institution on the matter that Mr. Evans is raising? Is Mr. Fairweather authorized to do that?

MR. O'DONNELL: Well, he has certain information. I would simply say this, my lord, that if when Mr. Evans is through and when the Commission is through, anything is left open that the Commission thinks should be more definitely spoken to, I will be glad to get express instructions to authorize me to say what should be said in the circumstances.

MR. EVANS: I am not trying to embarrass my friend or the witness.

THE CHAIRMAN: The point is Mr. Cooper has told us repeatedly all through his examination that he occupies a special position.

MR. O'DONNELL: That is right.

THE CHAIRMAN: And he is only really qualified to speak from that point of view. He has repeatedly referred us, for instance, to Mr. Fairweather.

MR. O'DONNELL: Yes, on certain things outside his sphere of activities.

THE CHAIRMAN: And this is one of those things, isn't it, that is, speaking for the Company in its present - -

MR. O'DONNELL: I may assume that he is saying there that as to the Company's policy it is not he who fixes it, nor is it he who states what it is unless he is expressly authorized so to do.





THE CHAIRMAN: I am not saying this is not the approved statement of the Company's policy. I don't know.

MR. O'DONNELL: I am not either. I am simply saying I will get instructions which will make the position very clear.

THE CHAIRMAN: Because if these things should turn out to be really important on the questions before us, we may have to take better evidence.

MR. O'DONNELL: There is no doubt about it, and, as I suggested a few moments ago, if when Mr. Evans is through and when our evidence is through, there be anything left open or anything concerning which the Commission would wish more specific information, I would be glad to get instructions.

THE CHAIRMAN: Certainly the attitude of these railways towards each other is of the very greatest importance in this country when everything is in their hands.

MR. O'DONNELL: That is right.

THE CHAIRMAN: In the way of railway transportation. All right.

MR. O'DONNELL: Mr. Cooper has said that as far as he is concerned his view is what it is, and if anything more formal is required, I will be glad to get the position clear.

MR. EVANS: I am not trying to embarrass you.

MR. O'DONNELL: I know that. I am not embarrassed at all.

MR. EVANS: I mean, I don't want you to think I am trying to embarrass you, but I do think we ought to



have expressed on the record the official position of the Canadian National on this point. I have no doubt about it myself, I would like to say, but that what Mr. Cooper has said is the official position.

Q. As an accounting officer of wide experience, Mr. Cooper, would you also agree that a privately owned railway company such as the Canadian Pacific must find from its own resources and upon its own credit any capital monies it may require for improvements or for extensions, additions and betterments, and the usual capital needs?

A. You include in resources the revenues of the railway of course?

Q. Well, yes, I am speaking of it as a railway. I am going to say something to you about - -

A. My answer is yes.

Q. Yes. Now then, since that is so, I think you would agree with me that unless the Canadian Pacific can pay a reasonable dividend, it cannot obtain, except through earnings, any of this capital; in other words, it cannot go into the markets and get whatever new capital may be required?

A. Are you speaking of equity capital or both forms?

Q. I am speaking of the borrowing of money or of the sale of equity securities, whatever they may be. The dividend, the ability to pay dividends, has an effect on the credit of the company, doesn't it?

A. Yes.

Q. And I suppose that you are distinguishing in your mind this, that there might be a possibility of



borrowing without a payment of dividend; but that when you came to issue stock, then it would be clear that you could not issue the stock successfully unless there was a dividend record that was favourable, and indeed, in prospect.

A. Yes, I think your difficulty would be attached to the sale of common stock. It would not be attached to the sale of bonds or secured obligations. I think there is sufficient margin.

Q. In your case you are speaking of?

A. No, sir, I am speaking of your case.

Q. In my case, yes. I don't put it any higher than that. I think we are in agreement on that, that at all events a dividend record would provide an added cushion of security to an interest-bearing security if you are trying to sell it.

A. That is correct.

Q. Now, in your evidence at page 18653 in referring to the reconstructed annual deficit including that of the Newfoundland Railways, you said this very short passage:-

"On this basis nothing is available for a return on equity capital, nor does it give the Railway anything to 'come and go on'."

Then in referring to Exhibit 246 at page 18658, you commented on the fact that on the basis of the reconstruction of 1949 results, the surplus shown indicated a return of only  $3/4$  of 1% on the proposed equity capital amounting to \$1,800 million odd. Now then, I am not asking you to be explicit, I am not asking you to





tie yourself to a specific figure, because I think that would be unfair to you, but may I ask you this. I assume that you feel that  $3/4$  of  $1\%$  is too low a real return to earn on that equity capital?

A. I do.

Q. Now, have you any thoughts on the subject as to what would be a reasonable rate of return on that equity capital?

A. I am afraid I have not given that any study, Mr. Evans. I could not give you information or an answer on that question.

Q. I quite appreciate your position because I know it is a very difficult question, but I am trying to get from you a general answer without tying you to a figure. Would you think, for example, that the return ought to be substantially in excess of  $3/4$  of  $1\%$  which your statement shows?

A. I think it should. I don't think that \$13 million is an adequate return on business amounting to \$533 million gross.

Q. Yes. Now, you are there speaking of a return to equity capital. I think perhaps you ought to clear up what we are talking about when we talk about return. There was a discussion with Dr. Angus yesterday as to whether a surplus retained by the Company could be considered part of the return, and I am rather inclined to agree with the answer you gave; but so as to clear this up, do you agree with me that in the ordinary use of the term "return" in relation to investment, we include the return to the holders of the fixed interest securities, as well as the holders

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of the equity securities and also any surplus?

A. No, I would not consider part of surplus that portion of earnings which is needed to pay the fixed charges.

Q. No. I am sorry, perhaps it is my fault, but I am trying to define with you what is meant by the ordinary use of the term "return". I suppose that you must agree, because I think this is common usage, that when you speak of return in the ordinary general sense, you speak of return including a return to the fixed interest security holders, a return to the equity security holders in the form of a dividend, and such retained earnings as may come under the category of surplus?

A. No, I think we are a little apart, Mr. Evans. My use of the word surplus, to begin with, is what is left after you have met your obligations, and that a return would be that amount of surplus expressed as a percentage of equity capital.

Q. Yes, well, that is perhaps a narrower use of the word "return" in the sense that you are speaking of a return to the equity shareholder or the equity security holder. What I am trying to clear up for the record is that when we speak of return in the larger sense in which it dealt with in the public utility field, we also include as part of the return the three things I have mentioned: the obligation to pay fixed interest, the obligation to pay a dividend, and the necessity for a surplus. Then you speak of a return in the larger sense, not merely in the sense of a return to the shareholders. Are we sort of cleared up on that?

A. I understand what you mean when you speak of a return.



Q. Yes.

A. But I am saying that that is not what my mind conceives ordinarily as the meaning of the word "return". You and I look at this a little differently -- maybe my point of view is a little narrower than yours, and from the broader point of view and provided it is explained, I think I would go along with you.

Q. Yes. Well, I am not trying to ask you to accept my view. I was merely trying to clear up language, because when I asked you the question I think I should have made the distinction clearer before I asked you rather than afterwards; so that when I was talking to you about Exhibit 246 and you had said to me that  $3/4$  of  $1\%$  was in your view a lower return on the equity capital than should have been the case, I then asked you what you thought should be a fair return on that equity capital and I did not want to have any confusion between us as to the terminology we were using. That was all I had in mind. Now then, I think you did say to me that you had not given it study and I had said to you that I hoped that you--without being explicit as to a rate, I asked you whether you would say that the  $3/4$  of  $1\%$  indicated by Exhibit 246 by a reconstruction of 1949, would or should be greatly exceeded.

A. I will go as far as to say it should be at least twice as much.

Q. Yes?

A. And I think it should go even higher than that.

Q. Yes?

A. But as to how far it should go, I have not made the study which I should make if I were to answer your question more thoroughly than that.

Q. Well, I am quite content to have you answer it





in the most general terms because I quite appreciate that you could not be more explicit. Well, the point I want to make is that I think you will agree with me this far, that when a company, any railway company or any utility, is permitted to earn a rate of return on its investment or its rate base, however it may be established, that that way of looking at it is a permissible earning power and is not in any sense intended to guarantee that that earning power will in all circumstances be reached.

A. I agree with that.

Q. Yes, so that when I ask you this kind of question I am not trying to tie you to something as a guaranteed return, if you get my thinking. I am merely indicating to get from you, as nearly as may be in general terms, what you think a property of the kind which your Canadian National property is, should be allowed as permissible earning power having regard to, say, traffic conditions that may be obtaining in the future.

(Page 18927 follows)



A. I would prefer to give that question some thought before I express my -- you, as I take it, wish me to use a figure, a percentage -

Q. No, I just wanted to get something a little more in general terms of the nature of the return that might be expected in your mind to be a fair permissible return for the equity capital in the Canadian National. I do not expect you to take 2%, 4% or  $4\frac{1}{2}\%$ . By and large what I would like <sup>you</sup> to consider is whether you could say very substantially in excess of this three-quarters of one per cent which Exhibit 246 indicates.

A. Without studying it I think that an offhand opinion would not be particularly useful to the Commission or to you. You want an informed opinion.

Q. I quite do, yes, there is no doubt about that.

A. And a guess or even an intelligent guess is not going to be of any particular value. I am prepared to say that, in my opinion, a rate of return of three-quarters of one per cent on our equity capital is very inadequate.

Q. Then, just in order to clear the air a little further on terminology and so on, I understand this to have been a part of your answer to Mr. Covert yesterday, that in arriving at the dollar return which a property should be permitted to earn that dollar return is a product of the base, whatever that may be found to be, and the rate that is applied to the base?

A. Yes.

Q. Now then, in the special circumstances in which the Canadian National finds itself, I suggest that one could give effect to those special circumstances either in the base, the rate base, whatever you may decide it shall be, or in the rate of return to be used as the other factor

1. The first of the three main points of the report is that the Commission has found that the Government has failed to provide adequate protection for the rights of the people of the United States.

2. The second of the three main points of the report is that the Commission has found that the Government has failed to provide adequate protection for the rights of the people of the United States.

3. The third of the three main points of the report is that the Commission has found that the Government has failed to provide adequate protection for the rights of the people of the United States.

4. The fourth of the three main points of the report is that the Commission has found that the Government has failed to provide adequate protection for the rights of the people of the United States.

5. The fifth of the three main points of the report is that the Commission has found that the Government has failed to provide adequate protection for the rights of the people of the United States.

in that computation?

A. My preference would be that the base should be adjusted rather than the return.

THE CHAIRMAN: Have we a proper understanding of this word, "return".

MR. EVANS: I would be happy to do anything to clear it up.

THE CHAIRMAN: Are we sure that you and Mr. Cooper have exactly the same definition in mind? I understood Mr. Cooper a while ago to say - perhaps I understood him wrongly - that the return is what is left after the Company has met its obligations. He used the word "obligations". Is that right?

THE WITNESS: We were speaking at the time, sir, of surplus.

THE CHAIRMAN: Q. The word "return" was being used.

A. Yes, sir, and then I said that the return which I speak of here is the amount of surplus expressed as a percentage of equity capital.

Q. That is it - after what?

A. I think Mr. Evans, when he is speaking of a rate of return, is referring to what is termed net railway operating income expressed as a percentage of the depreciated investment in railway property.

MR. EVANS: I put to the witness just that.

THE CHAIRMAN: We would like to make sure when you use the word "return" you mean the same thing.

MR. EVANS: I can put this quite clearly. I asked the witness to say what the common usage of that term was and he and I were not speaking quite of the same thing but then we come to his terminology and we deal then with his use of the figure of three-quarters of





one per cent of a return on equity capital, and whether you use return to equity security holders or whether you use return in the larger sense of a return on the whole investment, to include these other things, it is clear that in either case the return in dollars is a product of the base and the rate of return. So that what I was suggesting then to Mr. Cooper was that taking his narrower interpretation of a return, that is, in the sense that it is a return to equity security holders, that you could either give effect to the Canadian National special conditions by adjusting the base or by adjusting the return, and Mr. Cooper expressed a preference for readjusting the base.

THE CHAIRMAN: For what?

MR. EVANS: Readjusting the base or adjusting the base on which the return should be expected.

Q. We are both talking in that sense, Mr. Cooper, of the base of equity capital?

A. Yes.

Q. I think we are cleared up on that.

A. But we are not yet in agreement as to what we mean when we speak of rate of return because rate of return, when you are speaking of the establishment of freight rates, as I understand the phrase, is net railway operating income, not surplus, net railway operating income expressed as a percentage of the depreciated investment.

Q. Yes. Well, perhaps I might explain it a little more clearly to your lordship. It really is not a difficulty. I do not think there is anything substantially between us but perhaps we ought to clear up the terminology. Let me put it this way. In the larger sense in which I think use is made of the word "return" in public



utility practice one speaks of it as the total net operating revenue which is available for servicing the capital securities and for surplus. Illustrating it this way, we of the Canadian Pacific have what we say is a depreciated investment base of something over a billion dollars. If the return were to be calculated on that base at  $6\frac{1}{2}\%$  it would mean that we would have permissible earning power, after operating expenses and taxes, of \$65 million. Out of that \$65million, we would have to pay fixed charges, dividends and surplus. So that that is the broader sense of the return.

In discussing it with the witness he has preferred to - and I am not quarreling with him -- : narrow it down to considering the thing straight from the return to the equity shareholders. It is only a part of the larger return.

THE CHAIRMAN: I wanted to be sure you were speaking of the same thing. Now, Mr. Cooper, you see what Mr. Evans means when he talks of return and you will bear that in mind.

MR. EVANS: I am coming to his language, to his use.

THE CHAIRMAN: You are coming to his language.

MR. EVANS: I want to come to his because I want to make it clear that we are talking about the same thing.

THE CHAIRMAN: Q. Then what do you mean by return?

A. Mr. Evans, in coming to me, is coming over to standard railway terminology. I am reading from a pamphlet issued by the Association of American Railroads giving the results of the class one railways for the year 1949. At the foot of the page they have this note:

"Rate of return is computed on the property investment of the carriers, including investment





"in road and equipment, material and supplies and cash, and after deducting accrued depreciation accumulated on the books of the carriers as of January 1, 1949."

That is what I am thinking of when I speak of rate of return as applied or used for ratemaking purposes.

Q. And your calculations have been made with these factors?

A. No, sir. This Exhibit 246 simply shows that the surplus, which is a very different thing from net railway operating income, is equal to a return of three-quarters of one per cent on the equity capital. You see it is a return on the capital.

Q. Yes, I see.

A. Whereas the rate of return used for ratemaking purposes is a rate in relation to the investment in property.

MR. EVANS: I think, we have got that cleared up to the satisfaction of both of us. I hope that the Commission is clear on it.

THE CHAIRMAN: When you talk of percentages and figures we want to make sure you are applying them in the same way. What may be sufficient in one case might not be sufficient in the other.

MR. EVANS: I am sorry that I did not hear that. Mr. Carson was speaking to me.

THE CHAIRMAN: I am just saying that having regard to rate of return as Mr. Cooper has just dealt with it from what he has read, and rate of return as he himself spoke of it previously, and what you have in mind, there may be a variety of needs, that is to say, the same figure that is used might be sufficient in one case and insufficient in the other.



"I have had a great deal of trouble, and I am not at all well."

"I am sorry to hear that, and I hope you will soon be better."

"I am not at all well, and I am not at all happy."

"I am sorry to hear that, and I hope you will soon be better."

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"I am sorry to hear that, and I hope you will soon be better."

"I am not at all well, and I am not at all happy."

MR. EVANS: I quite agree.

THE CHAIRMAN: So we would like, when the evidence is all in, to be able to make sure just what you are referring these figures to.

MR. EVANS: May I put it this way, that the Canadian Pacific --

THE CHAIRMAN: You asked Mr. Cooper whether he thinks a certain percentage is a sufficient rate of return.

MR. EVANS: I said on the equity capital.

THE CHAIRMAN: Perhaps you did.

MR. EVANS: I think the record is reasonably clear on that, but perhaps I should say that when the Canadian Pacific asserts here, or to the Board, that it should have a fair return on its depreciated investment base it is speaking of the return in the sense in which Mr. Cooper read from the Association of American Railroads bulletin. I think we can proceed on the assumption that unless we say otherwise I am going to treat of return in the sense of return on equity capital, so there will be no confusion between the witness, myself and the Commission.

Q. Now then, where we left off was that you had expressed a preference for a method by which the special considerations attached to the Canadian National should be recognized by a reduction in the base of equity capital on which the return is to be calculated?

A. Assuming the rate of return theory is to be made effective, yes.

Q. But whether it is made effective or not, to measure the permissible earning power is what I have in mind --

A. I do not see any point in adjusting the base if it were not going to be used. That was my point there.

Q. Perhaps it is my fault. I thought you said you would prefer to adjust the base rather than the rate?

MR. EVANS: I think that

the first thing I should like to say

is that I am very glad to see you

and I am sure that you will find

that I am very glad to see you

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A. On the assumption that this is going to be used.

Q. And what you have in your mind I think I can see, that in adjusting the base you might have to write down your equity capital in your books?

A. No, I do not think so.

Q. Oh, you do not?

A. I think for the purpose of computing this base a study would have to be made. If I could express my views rather than answer your question --

Q. I would be glad to have them.

A. It seems to me if you are going to move over to the rate of return theory that first you would have to establish., let us say for the Canadian Pacific, by some examination of the figures which it has produced what can be agreed upon as an allowable base, and the same sort of analysis would have to be made of Canadian National.

Q. Quite.

A. In that process it is obvious to me that a substantial amount of the investment as recorded in the ledgers would have to be set aside as not entitled to rank in the base for rate of return purposes.

Q. Yes. Having got to that point then what was left in the base could be treated as a commercial company would treat it, and the rate of return would be the commercial rate of return?

A. It would be on a comparable basis with your Canadian Pacific Railway.

Q. Exactly; I do not think there is anything between us on that.

A. Fine.

Q. Now then, since we have got to the point where it is in a measure agreed that the Canadian National should earn a return on the equity capital, in what way do you suggest

1. I am sure that this is going to be a great success.

2. I am sure that you have in your mind I think I can

see that in relation to the case you are alluding to.

down your opinion as to the case?

3. I am sure that this is going to be a great success.

4. I am sure that you have in your mind I think I can

see that in relation to the case you are alluding to.

5. I am sure that this is going to be a great success.

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see that in relation to the case you are alluding to.

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17. I am sure that this is going to be a great success.

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19. I am sure that this is going to be a great success.

20. I am sure that you have in your mind I think I can

see that in relation to the case you are alluding to.

21. I am sure that this is going to be a great success.

22. I am sure that you have in your mind I think I can

see that in relation to the case you are alluding to.



the proposal as put forward by the Canadian National would provide for that return?

A. I do not think it is implicit in that proposal that there is in contemplation the determination of a rate of return on the equity capital.

Q. But even though there is nothing about computation of a rate of return in what way would the holder of the equity capital securities of the Canadian National receive such return as might be permissible and might be earned?

A. I must confess that the mind of an accountant does not run along the same way as the line of counsel's <sup>you are asking me</sup> thinking. It seems to me/for certain things which would have to be developed under certain conditions. If the Canadian National is to be used as a yardstick --

THE CHAIRMAN: Q. Would you please speak a little louder?

A. If the Canadian National is to be used as a yardstick, and if the rate of return is to be computed as a return on equity capital or it is to be computed as a percentage of net railway operating income to depreciated investment, a study of that sort will have to be made, but until those things have been decided I am saying we have not given our thinking to it, and if you press me on these things all I can say is that I have not studied it, and I do not think I can go beyond saying what the principle is without expressing what that principle result in as a percentage figure one way or the other.

MR. EVANS: Q. I want to be quite fair to you about this. It did strike me a little that the provision was rather explicit as to what would be done with surplus, and it does seem to me that once you are as explicit as was Mr. Gordon's statement that there has been, perhaps unintentionally, a closing of the door to a means by which the





holders of equity capital can receive a return, and I am just wondering whether your thinking would lead you to suggest how that might be accomplished?

A. You see you are taking me back to this question of the use of surplus earnings, including the establishment of this rate stabilization fund, and I have told all counsel who preceded you that this is a matter for my friend, Mr. Fairweather --

THE CHAIRMAN: Please speak louder. You hold your head down and it is difficult for us to hear.

THE WITNESS: I am sorry. I have been trying to say so far that this question of the rate stabilization fund, into which Mr. Evans is now leading me, is a matter which is going to be dealt with by Mr. Fairweather.

(Page 18937 follows)



MR EVANS:Q.I just want to get this quite clear. I appreciated your reluctance yesterday -- and I do not say that in any invidious sense -- to discuss the rate stabilization fund as such, but there are some aspects of that fund in relation to the subject about which I am now speaking which are, I am going to suggest to you in due course, matters of accounting. Now, if I am not in the proper field when I come to that---

A. Oh, yes, if you are going to talk accounting, shoot right at me; it is quite all right.

Q. But on this subject of return, the question we were engaged in considering was how, in view of the rather explicit statement -- and I am not asking you to say anything about the stabilization fund as such at this moment -- how in the rather explicit suggestion for the treatment of surpluses is it proposed to provide a means by which the equity security holders can receive a return?

A. Where is the explicitness in this statement?

Q. Well, we can turn to the provision about the use of surplus. The use of the words "such surplus earnings" -- perhaps I should read the paragraph; this is on page 16 of Mr. Gordon's statement:

"Prudent business management and judgment have always approved the establishment of reserves in years of financial prosperity for use in the leaner years. On the assumption that our proposals are implemented, it is not unreasonable, as I have indicated, to anticipate that Canadian National will in some years have surplus earnings. The task of Management would be greatly eased in my opinion, also, concurred in by the Board of Directors, if there were a recommendation from your Commission that the Board of Canadian National use such surplus earnings . . ."



And then you go on to say what the fund shall be. Now---

A. But pardon me, Mr. Evans; I think you might have continued.

Q. Oh, I will; I will be glad to if you want me to.

A. The first purpose is to provide sufficient funds to cover expenditures for non-revenue producing improvements and betterments. I would say that would be the primary -- that is, it would have priority. The requirements to meet non-revenue producing improvements and betterments would have priority over any amount which might be transferred to a rate stabilization fund.

Q. I am quite happy to have you draw attention to that, because I want to have it cleared up.

A. So before you come to what can be transferred to rate stabilization fund, the inference there, at any rate -- and I think it is more than an inference -- is that surplus earnings would be used first to provide funds to cover non-revenue improvements and betterments.

THE CHAIRMAN: Not only that, but to provide sufficient funds to cover -- that is, you have to use it in the first place---

MR EVANS: Yes, I am not in any disagreement.

THE CHAIRMAN: Mr. Gordon apparently starts out with the word "reserve", you see. Well, I suppose the reserve is something that is left over after you have met all your obligations.

MR EVANS: Yes.

THE CHAIRMAN: Then he says, "Now, we will use that reserve," and then later on he calls it a surplus, but it is the same thing no doubt, "for two purposes." The first is to provide sufficient funds -- that is, if it is big enough, I suppose -- to cover expenditures for non-revenue producing improvements and betterments.





MR EVANS: Yes..

COMMISSIONER INNIS: Q. What is a non-revenue improvement and betterment?

A. The charging to investment account of the change in the price level.

Q. I beg pardon?

A. The charging to investment account of the change in price level. We were speaking yesterday -- you were not here, Mr. Commissioner -- I gave an example of the difference in accounting for a water tank, the difference in accounting in the one case being our present method of write in and write out and the alternative method of using the replacement basis, and I explained that under the write in and write out method the cost to replace in kind at today's prices over the cost of original installation for an identical unit of property is charged to investment account, whereas under replacement accounting it is charged to operating expenses.

Q. Yes, I can understand that.

A. I was going on, if I may, sir, to say that in the illustration I gave there was an item of \$6,000 added to investment account representing the change in the price level between original installation and the time of replacement. Now, I do not see that that produces any additional revenue to the railway at all. Then of course from time to time we are required by the Board of Transport Commissioners to separate grade crossings and things of that sort.

Q. What do you do with falling prices?

A. It has not been my experience, sir, to live in that period of time.

MR O'DONNELL: That has been the trouble.

COMMISSIONER INNIS: Q. There was a depression, I



seem to remember.

A. Sir?

Q. There was a depression.

A. Yes, that is true. Well, under the write in and write out theory, if the depression lasted sufficiently long, you would have a writing down of investment account when units of property are replaced at a lower price than you paid for them originally.

Q. Balance one against the other?

A. I don't know, sir, because over the years we know that the trend generally is upwards; the price level of today compared with what it was in 1900 or 1850---

Q. It depends where you pick the year.

A. If we could find the cost of original installation of ties, for example, we would find that they were put in -- and they are in our property account today maybe at 40¢ -- it could be less than that -- whereas today a tie is costing us \$1.70.

Q. I see what you mean by this.

MR EVANS: May I proceed?

Q. I think perhaps we are at cross purposes, and I want to try to straighten this up. When we are talking about the surplus earnings that Mr. Gordon was talking about, my understanding is that the surplus which was to be used to provide for these purposes was surplus after payment of fixed interest charges?

A. Yes.

Q. So that all the money remaining out of current net after payment of fixed charges in a given year would be put to these purposes for which Mr. Gordon said surplus earnings were intended to be put?

A. You infer that he said that all the surplus would go into A or B?



Q. Yes.

A. Well, we will go on that assumption, then.

Q. Now, in view of the fact that that has been expressly proposed, I was merely asking you how it was open under the proposal as made that the equity capital should receive a return. We have spoken of return as including the surplus, but I am saying as a pay out, as it were, or something to be received by the equity security holders?

A. Well, my answer to that would be that whatever amount it was, if it went into either (a) (b) or (a) plus (b) that constitutes a return on equity capital.

Q. Well, I think in the definition of the term that we have agreed on that would be true, but when you speak of a return on equity capital, one assumes in commercial enterprises that the total return to equity capital may be X, but the pay out to equity capital holders, security holders, may be one half of X or two thirds of X, leaving the surplus in the company's hands for reinvestment?

A. Now you have got an additional and a different conception of a rate of return.

Q. I do not think so. You tell me where I am wrong?

A. I think now you are trying to relate a return on equity capital to the amount of dividends which are actually paid by the corporation---

Q. No.

A. No?

Q. No; what I said was that the return to equity capital -- and I think I am right, and I hope you will put me right if I am not -- the return to equity capital would include not only the retained earnings but the paid out earnings?

A. Oh, I agree with that.





Q. So that if you in effect, as I suggest you have done, provided for no pay out but a retention of all these surplus earnings, you have not provided for a return in the sense that I am speaking about, as pay out to equity security holders?

A. That is so.

MR O'DONNELL: That is based on your interpretation of the meaning of the paragraph that you are speaking of. You put the assumption to Mr. Cooper, and he said he would go along with you for the purpose of discussing the matter and on the basis that it was an assumption.

THE CHAIRMAN: Well, Mr. Gordon starts out by telling us what he really means. He means what in the case of another company would be a reserve.

MR O'DONNELL: That is what it amounts to. In so far as the(a) provision is concerned, I am sure our friends do the very same thing. It is merely plowing back into the company certain moneys that they may have available from the earnings.

THE CHAIRMAN: Well, Mr. Gordon says sound practice -- I suppose he means in the case of other corporations -- is to keep a reserve in good years to be expended in leaner years; that is what he said. Now, that, I think, is what he means when he talks further on of a surplus. He means something as to which otherwise he would not be able to say, "We have met all our obligations, and we have so much left."

MR EVANS: Yes.

THE CHAIRMAN: "Now, what shall we do with it?" Now, he says in the case of an ordinary company they would make it a reserve to be used in leaner years, and he says, "We can do that in part. We will use it to cover expenditures for non-revenue producing improvements and betterments"



-- that is the first thing -- he uses the word . . .  
"sufficient" -- then I would assume that if there is any-  
thing left, then he would go on to (b) and use what is left  
to establish what he calls a rate stabilization fund.

MR EVANS: Yes.

THE CHAIRMAN: Then that would be used in leaner  
years, you see, according to his idea, to make up for  
deficiencies in earnings.

MR EVANS: Yes.

THE CHAIRMAN: I think that is his whole case.  
Am I right, Mr. O'Donnell?

MR O'DONNELL: That is my understanding, my lord;  
and I do not think it is intended that there should be an  
unreasonably large sum in the rate stabilization fund, if  
that is what is troubling my friend.

COMMISSIONER ANGUS: Q. Might I ask this question:  
At the top of page 16 it says:

"These measures, if put into effect, should enable  
Canadian National, on the average, to meet its fixed  
charges . . ."

That is, on the average, no surplus, as I read it. Then  
lower down it says:

" . . . to anticipate that Canadian National will in  
some years have surplus earnings."

Reading those two together, is it fair to say that on the  
average you are contemplating surplus earnings equal to zero?

A. Equal to what, sir?

Q. Zero.

A. On the basis of 1949 we would have surplus earnings  
of \$13 million. Advance it one year to 1950; in 1950, which  
is you might say the closest we can get to present-day con-  
ditions, we have furnished to the Government our operating  
budget for the year 1950. It shows a deficit for the year



of \$44 million. Against that should be applied the amount of additional revenue which we expect to receive as the result of the recent order of the Board of Transport Commissioners increasing the 8 per cent to 16 per cent. That figure is around \$11 million, so that our best forecast as of today is for a deficit of \$33 million. If the proposals advanced by the President were approved and made effective as of January 1, 1950, we would finish up with a surplus of \$2 million, and that is without any regard for any additional wages which may be granted as the result of negotiations which are now in progress, and it is on the basis that traffic volume will continue as it was forecast at the date the estimate was made.

I called attention yesterday to the fact that the \$13 million would disappear if we had a reduction in traffic volume of  $2\frac{1}{2}$  per cent, and that at the present time -- that is, January and February -- our traffic volume is down 8 per cent as compared with a year ago.

So, taking that as the closest estimation that we can make of the situation as it is in 1950, as adjusted by these proposals, we just about break even.

Q. Well, does that amount to saying that I am right in putting the interpretation which I in reading this and hearing from Mr. Gordon put on it, that what is contemplated is a surplus in some years, but on the average breaking even?

A. I think that is a fair interpretation.

THE CHAIRMAN: That is what he says.

COMMISSIONER ANGUS: Yes, that is what he says.

THE WITNESS: From the submission as a whole, yes.

COMMISSIONER ANGUS: Q. And therefore there is on the average no return in the sense in which you are using the word to the equity capital?

A. Not under conditions as they exist today.





MR EVANS: Q. Just so we will not be at cross purposes, may I put it this way to you, that the proposal in so far as it proposes the use of surplus earnings provides no return in the sense of a pay out to equity security holders?

A. I would agree with that.

Q. And, whatever the surplus may be, there is nothing to indicate that at any stage, no matter how large the surplus, there would be any pay out to equity security holders?

A. It may not say that, but I think it is quite reasonable, that if the surplus earnings were so good, after providing for capital and some transfer to a reserve, that there was still a sizeable amount of money left, it would be turned back to the Government.

Q. Now, I want to come back to that, but before I do come back to it I just want to ask you to consider with me a matter that you discussed with Mr. Covert. I think you said -- and I am not trying to embarrasss you in this question at all -- you gave it as your personal view -- this was at page 18689 -- that you had always thought of these adjustments in terms of income bonds, certainly so far as it was related to the repatriated securities. You remember that statement?

A. I said that, yes.

Q. Now, please believe that I am not trying to get you to disagree with your President, because that is the last thing in my mind, but I am merely putting this to you as a suggestion: Certainly the income bond idea, whatever may be the official position with regard to it, would provide some pay out to what would be the equivalent of equity securities of the Canadian National?

A. Yes.



Q. In other words, an income bond is a means by which the holder of the security is entitled to participate only in earnings when they are made and to the extent made?

A. As defined in the contract.

Q. Yes. Well, there may be differences between them, but generally speaking we speak of income bonds as contingent interest bonds, in the sense that no interest is payable unless it is earned?

A. That is correct.

Q. So that had the matter of income bonds appeared in the proposal, there would have been some provision for pay out to the holders of securities which are convertible in this recapitalization?

A. I think so.

MR O'DONNELL: The Government are the sole owners.

MR EVANS: Quite. There is no trap in this at all.

Q. I am just suggesting, as I put it to you before, that on the face of the proposal made by Mr. Gordon there is no provision for pay out to equity holders, but under the---

A. No, but on the other hand there is no bar against a pay out.

THE CHAIRMAN: Q. There is no what?

A. There is no bar or prohibition against a pay out.

THE CHAIRMAN: Well, when you talk of equity holders -- is that what you said?

MR EVANS: Yes.

THE CHAIRMAN: Do you mean anybody else than the Government of Canada?

MR EVANS: No, sir. I am just talking in general terms. Everybody agrees that the Government owns the equity securities, and Mr. Cooper says he thinks they should own all of them, and I have no disagreement with that at all.



COMMISSIONER INNIS: I would like to ask a question in that connection.

Q. How/<sup>much</sup>do you think the Government should expect in returns on its capital which is being loaned to the Canadian National Railways? I was wondering whether you had that in your mind when you referred to your dissatisfaction with three-quarters of one perccent.

A. I went so far as to agree with Mr. Evans, that it should be at least twice as much, on the traffic levels of today, but I have not formulated in my mind a definite figure such as say 3 per cent or anything of that sort.

Q. Well, it really would not be your problem to say; it is the problem of the Government as to how much they should allow you and what interest rates they should expect.

A. No, but---

Q. Now, it is not fair to ask you to put yourself in the position of the Government, but I wondered whether you had that in mind when you were---

A. I do not think the determination of the rate of pay out or rate of return on equity capital is to be decided so much by the owner of the equity capital as it will be decided by the rates fixed by the Board of Transport Commissioners.

COMMISSIONER INNIS: But, after all, the taxpayer has some interest in this problem, surely.

MR O'DONNELL: The situation, if I may just interrupt there, with respect to these surpluses/<sup>is</sup>provided for in the Capital Revision Act, section 12. As Mr. Cooper said a moment ago, there is no bar against paying out. If there is anything left, then it can be turned over. Section 10 of the Capital Revision Act reads:

"10. Whenever the accounts of the National Railway





System as certified by the auditors appointed by Parliament show surplus earnings after the payment of all charges including interest on securities held by the public, the directors of the Canadian National Railway Company may cause to be paid over to the Minister for the Consolidated Revenue Fund all or any part of any such surplus earnings."

There is no bar to paying those over. All Mr. Gordon's proposal is saying here is, it might help if the Commission were to recommend that some portion of those surplus earnings, if and when there are any, be retained for the purpose of plowing them back into the property just the way the other roads do, or even be held as a reserve, a certain amount, and my understanding of it would be that it is not to be any colossal sum for the purpose of this rate stabilization fund, but permitting them to hold it. Under the statute I would think they are entitled to do that at the present time; under the statute there is provision for the paying out, and all the Government can expect to get is what is left in any case. What is left depends upon the rate as fixed by the Board of Transport Commissioners. Heretofore the rate has been fixed upon the basis of the C.P.R.'s requirements, and on that basis we get what they get as to rates. If we have anything left the Government is entitled to have it; the directors may pay it over; there is no bar to it.

COMMISSIONER INNIS: I am afraid we are arguing at cross purposes.

MR O'DONNELL: I understand -- I was not answering you, Dr. Innis, at the time -- you asked what might be a reasonable expectation.

COMMISSIONER INNIS: Yes. I am, for example, putting it in the way in which Mr. Frawley might put it,



as a representative of the consumer: What would be the rate at which the Government should allow the Canadian National to have capital? Is it now 3 per cent in your mind, or  $2\frac{1}{2}$  per cent, when you say double three-quarters of one per cent?

(Page 18950 follows)



MR. O'DONNELL: All I would say to that, if I may interrupt you, is that it must be assumed, I think, that the government intends to receive only such amount as is left from the proceeds of the rate as fixed by the Board of Transport Commissioners. In other words, the Canadian National Railways have been put under the provisions of the Railway Act, and in so far as rates are concerned, it is the Board of Transport Commissioners that fixes those rates. As to how they fix those rates they are absolutely free and unfettered, and as far as I understand Section 325 (5) a just and reasonable rate they may arrive at by various ways in the judicial exercise of the discretion which that provision allows them.

COMMISSIONER INNIS: I doubt whether the taxpayer would be willing to concede to the Board of Transport Commissioners the power which you have inferred.

MR. O'DONNELL: That is possibly something that you may be right in. At date I think that is the way it stands.

COMMISSIONER INNIS: After all, it is the taxpayer who is concerned. It is a matter of the budget, it is a matter of parliamentary power completely.

MR. O'DONNELL: Absolutely.

COMMISSIONER INNIS: And it seems to me you must come back to the whole question as to what parliament decides is a reasonable rate, and not to have it determined by the Board of Transport Commissioners.

MR. O'DONNELL: That may be, but as the Act stands, I think the Board is the controlling factor, and it might be, as you say, Dr. Innis, it should be changed. I don't know.





MR. FRAWLEY: Dr. Innis, would it be too rhetorical  
What  
a question to ask: does the government expect the Canadian  
Broadcasting Corporation to pay by way of return? Obviously nothing at all.

COMMISSIONER INNIS: I am just wondering whether they are parallel bodies. I don't think the Canadian National would like to put themselves in quite the same category.

MR. EVANS: May I suggest to you, Dr. Innis, that the taxpayers' interest might be improved or might be very favourable in getting a return, a fair return, whatever that may be, on the taxpayers' investment in the Canadian National, and have it paid by the group of people in the community who use the railway services. That is just a suggestion in answer to your question.

COMMISSIONER INNIS: Yes, but parliament has never accepted that yardstick. They have always regarded the Canadian National Railways as government-owned railways and having some difference to what you have in mind.

MR. EVANS: Yes. You see, the result, if that were to be the principle to be applied, that would be what we feared, that if the Canadian National were not permitted to earn a return payable to the government as the holder of equity securities, that might result either directly or indirectly in a rate structure that would ruin the privately-owned Canadian Pacific. I take it that parliament would have to take the decision as to whether they wanted to have these consequences flow from it. My whole object here is to try to develop something practical as a solution to a difficulty that we see in these proposals, although we are not opposing these proposals as such.



COMMISSIONER INNIS: That is precisely the point. That is why I think the problem is <sup>at</sup> what rate the government is willing to loan its capital. That is very important from your standpoint.

THE CHAIRMAN: Then I quite appreciate all that you are doing. We all do. But I think there are two considerations: One is that there should be no mistake in the use of language, that is, the double use of language by both parties, and that we should have the very best evidence from the Canadian National Railways, that is, the most authoritative evidence as to just what is intended by these representations made to us.

MR. EVANS: Yes.

THE CHAIRMAN: And of course all along what you are getting is Mr. Cooper's personal opinion, excepting on matters of accounting.

MR. EVANS: Well, he has qualified some of his answers.

THE CHAIRMAN: I am not finding fault with you.

MR. EVANS: No, he has qualified some of his answers to say he is giving personal opinions.

THE CHAIRMAN: Well, a great many of them.

MR. EVANS: Yes, I think the record will show that he has not so qualified -- if Mr. Cooper wants at any time to qualify an answer of that kind then, whether I pressed him or not, whether he answered me or not, I might have to suggest to my friend that -- some one be produced.

THE CHAIRMAN: Mr. O'Donnell, has Mr. Evans so far asked any question that you are not prepared to have answered by the proper witness?

MR. O'DONNELL: No.

THE CHAIRMAN: Whoever that might be?

MR. O'DONNELL: Whoever that might be.



THE CHAIRMAN: Every question he has asked you can answer?

MR. O'DONNELL: I have not followed all his questions, I am sorry to say, as intently as I should have possibly, but I am satisfied that any question that can be answered we will be glad to have some one answer.

THE CHAIRMAN: Any question that can be answered?

MR. O'DONNELL: Yes.

THE CHAIRMAN: I would assume that so far ---

MR. O'DONNELL: I think that he has had an answer to everything he has asked. I don't know whether it is satisfactory to him or not, . . .

THE CHAIRMAN: You see, as Dr. Angus said a while ago, at the top of page 16 reference is made to the desiderata of the company, and it is to have certain measures put into effect which might enable the Canadian National on the average --

MR. O'DONNELL: That is right.

THE CHAIRMAN: I suppose that is over the years.

MR. O'DONNELL: Over the years.

THE CHAIRMAN: To meet its charges including interest on funded debt?

MR. O'DONNELL: That is right.

THE CHAIRMAN: But only on the average. Then there must be something above and below to make the average.

MR. O'DONNELL: Sometimes I suppose there would be a deficit and sometimes there would be a surplus.

THE CHAIRMAN: Then, you see, you go on to say that when there is a surplus that you would otherwise just put in reserve, then you are going to devote it to certain other ---

MR. O'DONNELL: It is really putting it into





reserve for those two things. After all, any surplus at the present time, under the Capital Revision Act it may be turned over (the section I read) to the Government, and I don't think Mr. Gordon intends to restrict the language of that section at all. What he is simply saying is that a recommendation of this kind would be useful in helping to manage this property which is very cumbersome.

THE CHAIRMAN: I suppose this is held in mind, is it, that in those years which fall below the average, where you are not able to meet your fixed charges and so on, then of course Parliament looks after that. Is that it?

MR O'DONNELL: That is the way it arises today. If and when there are surpluses I assume that what he would like to do is to be able to retain some portion of it for the purpose of ploughing them in the same as an ordinary company, or even holding it against the leaner years, but not in any fabulous or astronomical amount, because at the present time it doesn't look as if they will ever amount to that.

THE CHAIRMAN: So then if you go below the average in one year and are unable to meet fixed charges and so on, then Parliament looks after that.

MR O'DONNELL: Yes.

THE CHAIRMAN: And the next year, if you are able to meet your fixed charges and have a surplus, then you go on and treat it as a surplus: you don't go back to the year before?

MR O'DONNELL: No, each year stands on its own merits.



THE WITNESS: If I may interject there, Mr. O'Donnell, it does seem to me that a reasonable arrangement would be that if we had a surplus in the reserve---

THE CHAIRMAN: Q. In the where?

A. If we had something in the reserve and we ran into a deficit, that the Government would certainly expect us to pay that deficit out of the reserve instead of advancing additional monies.

Q. Yes, but of course you are going to use your,-- what otherwise would be in reserve, you are going to use it right away to cover your expenditures for non-revenue producing improvements, and it is only if there is something left over that again that should have this stablization.

A. Yes.

Q. But you say even then the Government might take it from you?

A. I am sure they would, if there was a deficit and we had asked them to pay up the money for it and we had money in the reserve.

Q. But, you see, Mr. Gordon asks . us to recommend that these things be done, that is to say, at least the Government should not take it from you.

MR O'DONNELL: That is what it amounts to.

THE CHAIRMAN: Is that right?

MR O'DONNELL: Allow us to hold a certain . portion of surplus for these eventualities.

THE CHAIRMAN: He asks us to make that recommen-  
dation.

MR O'DONNELL: Heretofore every year---

THE CHAIRMAN: Whether as a reserve you are



to be authorized to use it---

MR O'DONNELL: For these purposes.

THE CHAIRMAN: Yes.

MR O'DONNELL: Heretofore each year, as I understand it, has been dealt with on its own basis. If there was a deficit it was paid, and if there was a surplus it was handed over or used for company purposes.

COMMISSIONER ANGUS: Are we simply discussing the proper disposal of an income which on average is to be zero according to these plans, or are we discussing the possibility of an alternative plan which might make that average positive? I think, as Mr. Evans said, you agree it would be desirable that you should earn more than  $\frac{3}{4}$  of 1%.

MR EVANS: I think Dr. Angus was asking a question.

THE WITNESS: Did he expect to get an answer?

MR EVANS: That is for you to say.

---RECESS

---ON RESUMING

MR EVANS: Q. Mr. Cooper, before I leave that question of surplus I just want---

A. Are you going to leave it?

Q. I am going to leave it eventually. I am sure we will both be glad, won't we? I just want to clear up one thing. Mr. O'Donnell said there was no bar to a payment of some---

THE CHAIRMAN: There was no what?

MR EVANS: No bar to a payment of some part of this surplus to the Government.

THE CHAIRMAN: Except insofar as we might recommend to the contrary according to what Mr. Gordon asks us to do.





MR EVANS: Quite, sir, but I am speaking now of the proposal as such.

THE CHAIRMAN: That is, the proposal that we should make a recommendation that the Canadian National should use such surplus earnings---

MR EVANS: : For these purposss.

THE CHAIRMAN: For these purposes (a) and (b), not to return any part to the Government.

MR EVANS: I am speaking now of what Mr. O'Donnell argued that this did not contain a bar to the payment over, and I was wondering if I could not pursue this with the witness to see whether it really does not in its present terms contain that bar.

THE CHAIRMAN: Yes, you are talking of the language, yes.

MR EVANS: Yes.

Q. May I ask you this, whether you do not construe that language in Mr. Gordon's statement as in effect a bar to payment of some part of this surplus to the Government.

A. I don't construe it so and I am sure he doesn't.

Q. Have you any view as to when the point would be reached at which such a surplus would be paid to the Government?

A. I think that point is so far removed that it is not worth discussing.

THE CHAIRMAN: I agree, Mr. Evans. You see, let us take the language, Mr. Gordon tells us that the task of management would be greatly eased in his opinion. Then he says:

"also concurred in by the Board of Directors.."  
(Well, Mr. Cooper is a director)

". . . if there were: a recommendation from your



Commission..."

(that is, from us)

". .that the Company use the surplus earnings..."  
for these two purposes, it seems to me.

MR. EVANS: Yes.

THE CHAIRMAN: As far as the language goes he tells us something that must have been arrived at after very mature consideration because he refers to the Board of Directors as well as himself-- "There is our final say on this." Now, Mr. Cooper tells us that he should not be called upon to talk about that. That is what you are saying aren't you?

MR. EVANS: I thought he expressed a view.

COMMISSIONER ANGUS: Didn't you say you were sure that was not what Mr. Gordon meant?

A. I felt sure that he did not intend by that that <sup>ment.</sup>  
under no conditions should a payment be made to the Govern-

THE CHAIRMAN: Then the recommendations would be changed to put in a clause (c), is that it?

A. All right.

MR. O'DONNELL: I think the way it has been construed by Mr. Evans - and that is why I referred to the word "all" way back at the beginning---

THE CHAIRMAN: I beg your pardon?

MR. O'DONNELL: The way it has been construed on the very literal basis is that any surplus would be retained for that purpose, and Mr. Cooper, when it was put to him that way, said: "I will go along with you:" but he has since said, if I understand him correctly, that he is sure it is not intended in that way. It is not all surplus; it is the right to hold some . . . (Page 18959 follows)



of the surplus. And, as I think he said just a moment ago, it was rather far removed from the point where it was ever going to become really operative or of any great consequence. Wasn't that what you were saying?

THE WITNESS: Mr. Evans was saying something about did I have some point in mind.

MR EVANS: Q. Did you have some point in mind at which you would feel that there might properly be made or expected to be made a payment to the Government out of surplus?

A. Well, I think that is a reasonable question but frankly I don't see any big surplus arising out of this arrangement.

Q. Yes, I am going to come to that at a little later stage.

(Page 18960 follows)





A. Let me just say that I feel that the possibility of surplus earnings under this adjusted set-up is not very large.

I think we should do very well indeed if we broke even, one year with another; and certainly, if we have to provide for these capital requirements, I feel positive that this fund, which is taking on so much importance, should not be given that importance at all. I do not see it as a very formidable difficulty in this proposal.

Q. I am most anxious not to give it too much importance. But I am not going to under-emphasize it at the moment.

I want to get really what is in the mind of the Canadian National management on this subject, and I am not doing it with the idea of embarrassing you.

I am trying to indicate -- that is, I shall develop, it may be unwittingly, and without any design on your part at all -- a threat to the Canadian Pacific which, perhaps, can be remedied quite simply if you understand my approach to this thing. And if we proceed on that basis, I am sure that we will understand one another.

THE CHAIRMAN: Are you still talking of these surplus earnings?

MR. EVANS: I was speaking, generally, to him about a surplus, yes.

THE CHAIRMAN: If you were talking only to these surplus earnings, this proposal, and you spoke only with respect to the Canadian Pacific, could you tell us what you think the threat is, so that we would know it and could follow you the better?

MR. EVANS: I should be quite pleased to do so. I intended to develop it in my cross-examination later, but I shall do it now, if you think it desirable.

THE CHAIRMAN: Yes. It would make it easier for us.



MR. EVANS: Yes. Well, frankly, we see it this way: we see a greater possibility of surplus earnings than do the Canadian National.

THE CHAIRMAN: Do you mean for the Canadian National?

MR. EVANS: Yes, for the Canadian National. And we see, in using all of that surplus for the purposes mentioned, a means by which --

THE CHAIRMAN: You mean (a) and (b)?

MR. EVANS: (a) and (b). (a) we are not arguing about at all.

We have the same character of requirements for non-revenue additions and betterments. We call that surplus in the sense that we must have that surplus as part of our requirements; and if you are on a rate of return basis, it must be taken out of what the return provides. So we are not in any controversy over (a).

But having regard to the fact that the fixed charges as a result of this proposal could be as low as \$12,000,000 odd per year, and assuming that the \$300,000,000 fund is all used for retirement of debt, then the money remaining, after payment of those fixed charges is used for these additions and betterments, and now, for the purpose of argument, assuming our figure of around \$15,235,000 is allowed by the Board, and assuming it earned that for the Canadian National for some time, they could thus have interest charges of about \$12,000,000 odd, and \$15,000,000 odd for these additions and betterments; we think it is definitely possible in the future that the Canadian National might have a surplus of the size of the wartime years, and I will develop that.

If that were so, and assuming it would be so immediately, the payment into a rate stabilization fund to be



used in poor years to avoid the necessity of rate increases, could put our friends of the Canadian National in one of two positions; either (i), they would feel they could not properly join us in an application if they had money in such a fund; or (ii), even though they wanted to, the pressure on them would be such as to prevent it; and if they should, in either of these cases, fail to join us, the result could be that the requirements of the Canadian Pacific would not be met, and in the result, we could not earn enough to keep us alive.

That is as clearly as I can put our position. And, as I say, it is not that we attack our friends of the Canadian National as not being entitled to some relief. We are attacking the matter entirely from the standpoint of: how can you give relief and at the same time provide the protection which we, as a privately owned company, require?

That, in a nutshell, is the position we take.

THE CHAIRMAN: You have kept in mind this stabilization fund and its relation to the freight rates?

MR. EVANS: Yes sir.

THE CHAIRMAN: Well, suppose there should be a surplus anyhow. Have you any other way of saying what could be done with that surplus?

MR. EVANS: I was going to make some suggestions to the witness. I have no concrete suggestions myself, but I was going to get his views on it.

THE CHAIRMAN: That must follow.

MR. EVANS: Oh, quite!

MR. O'DONNELL: My lord, I think, again, it would be well to wait until Mr. Fairweather has explained how he sees the rate stabilization fund. Mr. Cooper said it was not his affair, and that Mr. Fairweather would explain





what is intended by it, and when the understanding of the Canadian National concerning it is before the Commission, then we would be in a better position to evaluate the danger.

I was glad to hear Mr. Evans say that he thinks we should all buy Canadian National stock since we are going to have good years, and all that, but after Mr. Fairweather has explained it, I think it would be better.

THE CHAIRMAN: I may be anticipating, but while we are on these things, we have been talking, from time to time, of the necessity for amendments.

After all, it is quite evident that the order in council is so worded that anything serious we should propose ought to be -- I mean, where there is an act to be referred to, such as for example, the Canadian National Railways Act, you have a chapter on finances; and I think it might be better to fix these things beyond any equivocation, Mr. O'Donnell, if you were to put it into the shape of a statutory amendment, and to say just exactly what it is you are seeking to amend.

The whole scheme is embodied under the heading of "surplus earnings on page 16 of Mr. Gordon's statement. Or, if it is not properly an amendment, you might recast it.

MR. O'DONNELL: That is right. That does not require an amendment, in my view. It is a recommendation to be made; and in so far as that is concerned, it might affect government policy if a recommendation were to be forthcoming.

As to the other matters where express relief is asked for through the exchange of fixed charge securities for equity securities, and the other relief, there we would possibly have to have some amendment which we would



produce in due course. But, as to the surplus earnings aspect of the matter, the word is for a recommendation.

THE CHAIRMAN: It is one thing to ask for a recommendation from another body such as the Board of Transport Commissioners; but here the recommendation is from yourselves. It must mean something.

MR. O'DONNELL: We are asking that this Commission, after hearing how this thing is to work, should recommend that the Board of Directors of the Canadian National should use some of these surplus earnings in a manner specified.

THE CHAIRMAN: Mr. Gordon says that it is the considered opinion of your Board of Directors. He must mean something which would be compulsory on the company. But we are not sure of it now, and I think it is of very very great importance. We are all convinced of that.

MR. O'DONNELL: Yes.

THE CHAIRMAN: So I would say that you should give your best consideration to a restatement.

MR. O'DONNELL: My understanding is that they ask your Commission to make this recommendation, and they are not asking for an amendment in the statute.

THE CHAIRMAN: How can I make a recommendation that I do something unless you give me the authority to do it?

I hoped you had given consideration to it. And if Mr. Fairweather is not empowered to express the views of the company, perhaps somebody else is. I do not know who. But I would like to have, in answer, a recast of this.

COMMISSIONER ANGUS: Would the recommendation be contingent on the surplus being, on average, zero?

MR. O'DONNELL: I think that is the position which Mr. Cooper anticipates. It will be, from what he can see, at present.



COMMISSIONER ANGUS: But, from Mr. Cooper's point of view, if the average is greater, should not something else be done?

MR. EVANS: Q. Well, Mr. Cooper, I have asked you about the matter of income bonds, and I have said to you that I was not trying to get you to disagree with your president, because you said that he had had a different view; but I was just merely indicating means by which the return could be achieved or paid out to the government as the owner of securities, the income bonds, that the principal might have some value.

Now, the point I had got with you was this: that in your statement on page 18689, which I have already referred to, you had expressed this as something which had been in your thinking, and you qualified it, at least as far as it was related to the repatriated securities.

Had you an amount in mind there?

A. It was in the order of \$400,000,000.

Q. It was in the order of \$400,000,000, and that would be something which was in your thinking, at least as a personal matter?

A. I did refer to it, I am sure, but I cannot find it in the record.

I did say in my evidence that, around 1946 or 1947, the company made a recommendation to the government that the loans which had been received from the government in order to enable the company to pick up these repatriated securities -- that those loans should be converted into income charge bonds.

Q. Yes?

A. And that is why my thinking in connection with income charge bonds is related to the figure of \$400,000,000.

Q. Yes?





A. It is not that I think that this amount of \$760,000,000 should be divided.

Q. No?

A. It was dealing with the matter set out.

Q. Yes. I am not trying to tie you to that because I was going to refer you to the brief itself, which, at page 62 -- have you page 62 there?

You see the paragraph which begins just above the middle of the page, which reads:

"At the end of 1948 such loans amounted to \$760,494,825."

And then you deal with the amount of interest on it. And then the fourth sentence begins this way"

"Had receivership proceedings been resorted to, at that time, it is not unlikely that these loans would have been put on an equity or contingent interest basis."

Now then, I assume, at that time, this relates to the 1922-1923 period?

A. Yes.

Q. And that what you are suggesting there is that, had there been a receivership proceedings at that time, that \$760,494,825. --

A. At that time it was \$804,000,000.

Q. But, at all events, the \$804,000,000 --

A. Yes.

Q. Instead of being converted to equity, might have been converted to income bonds?

A. It could have been one or the other, or a combination.

Q. Yes. As a matter of fact, my understanding of the United States reorganizations is rather imperfect, and I hope you will correct me if I am wrong.

It is rather the usual thing, as I understand it,



in bankruptcy proceedings, through which so many United States roads have gone in the past few years, to establish a substantial part of the interest-bearing securities in the form of income bonds?

A. I agree with you, but I am not quite sure of the word "substantial"; but definitely, as a result of re-organization proceedings in the United States companies, they emerged with part of their capital represented by income charge bonds.

Q. Yes. Now, I suppose it is also fair to say this: that the greater the variability of earning power over a period that is used as a test, the greater proportion of interest-bearing securities which will be on an interest-bearing basis?

A. I would think so.

Q. Those proceedings, and the reference made in your evidence and, I think, in Mr. Gordon's statement, to the great fluctuations in net earnings of the Canadian National would rather suggest the possibility that the income bond solution might be a useful one to put forward.

Would you agree with that?

I am not asking you now to say that you disagree with your president. I am merely asking you: would that, perhaps, not meet that kind of situation?

A. Will you please tell me what advantage you see in that?

Q. I would be glad to.

I see the advantage of the government, as a holder of the income bonds, getting a part of the returns, if they were earned.

A. Is that on the assumption that under this arrangement it would not get a part of the returns?

Q. I have not said, in view of what you said, that it



might not. I am suggesting to you that, in the nature of things, some protection to the Canadian Pacific might be afforded through the use of income bonds, as insuring that the government as holder of the securities did get a return, if it is earned. And if it is not earned, then there would be no return.

A. You see some danger to the Canadian Pacific which I do not see at all.

Q. I am not asking you to agree with me that there is a danger; but I am asking you, on the assumption that there might be a danger, would that not be the means of avoiding it?

A. I think it is doubtful whether it would meet the difficulty that you have particularly in mind.

COMMISSIONER ANGUS: Do income bonds normally have a maturity?

MR. EVANS: Oh yes, so far as I know. They need not have, but they do, as a rule. There are a lot of variations in the terms. But I was not so much concerned with the details of the terms of the issue as with the principle of it.

MR. EVANS: Q. Now then, there would be this advantage, I think you will agree at least: that if that were the means by which a solution could be found, it would, at least, give you freedom from the substantial burden of fixed charges?

A. Yes, and it would give us another advantage: if we were subject to income tax, and the interest on income bonds was an allowable deduction, then our taxes would be less.

Q. Yes. But I suppose there would be the same destination for the money in any case?

A. Yes.

MR. O'DONNELL: And there is now, undoubtedly.





MR. EVANS: Yes.

Q. Now then, we have got to the point where I want to discuss with you for the moment this (a) item in your surplus?

A. No. 1?

MR. O'DONNELL: I thought you had left that surplus.

MR. EVANS: I am going to leave it as quickly as I can. This is just another phase of the matter.

MR. O'DONNELL: Surely.

MR. EVANS: Q. I suggest to you, Mr. Cooper, that in these reorganization cases in the United States, where there have been companies reorganized whose history and prospects indicate violent fluctuations in net operating income, that a capital fund is provided which can be built up by charges ahead of income bonds, but after fixed charges. Are you familiar with that practice?

A. I am afraid not.

Q. I suggest to you -- and I wish you would correct me if I am wrong -- that most -- and I go so far as to say most -- of the railroads having substantial variable earning power, have, in these reorganizations, ranked their contingent interest requirements after provision for capital funds?

A. Yes, I understand that is so.

Q. Yes. So that so far as the necessity for (a), with it we are most sympathetic; that is to say, the surplus monies for the provision for non-revenue producing capital additions and betterments, that might be a solution which would not imperil your need for that surplus, if the practice in the United States in those cases should be adopted in your case?

A. The provision that a portion of surplus earnings



ought to be set aside for capital purposes would be one of the conditions of the issue of the income charge bonds.

Q. Well, it would have to be. You would have to have, if you recall the way these reorganization plans operate; they have usually a very elaborate provision for what is available net income.

A. It would be written into the bonds themselves.

Q. You would have to have provision in the bond itself, and I assume, perhaps, from the statute, you would do what they do in those reorganization problems, you would have set up an order of priority of claims upon the available net income, and you would then find that in a large number of these cases, the capital fund could be put ahead of the income bond interest.

I suggest to you, and you can check me on that: my understanding is that that is quite the usual procedure.

A. Yes, I think that is right.

Q. Now then, I notice one remark you made in the course of your evidence yesterday at page 18689. I do not think you need to look at it because I think you will remember it.

You said that Dr. Clark -- no, it was the day before yesterday -- you said that Dr. Clark had once informed you that in his view the income bond was the lowest form of security. Do you recall that?

A. I do.

Q. I was going to suggest to you that perhaps Dr. Clark had in mind the buyer's standpoint, or the investor's standpoint?

A. I do not know what he had in mind. I do know that at this time we were talking about an understanding with the government for income bonds on the repatriated securities, and he said that income bonds are different, that they are

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the lowest form of securities, so far as he was concerned.

Q. I suggest to you that probably what he had in mind there was their market-ability as compared to that of fixed interests bonds?

A. I do not know what he had in mind, but I do believe that these income bonds as a rule are issued under reorganization proceedings rather than being sold on the open market.

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Q. Now then, at page 18691 you gave an answer to Mr. Covert that I want to discuss with you for a moment.

About the middle of the page --

THE CHAIRMAN: What page?

MR. EVANS: 18691; that is in Volume 100, my lord.

Q. You said this at the middle of the page:

"I would say that if the rate structure would stand it, there should be a return on equity capital, but I would not think that the entire amount of capital is entitled to what might be called a commercial rate of return.

Q. No?

A. But the entire equity capital might be entitled to a small rate of return, yes; and I showed this morning that --"

MR. O'DONNELL: Speaking of the Canadian National Railways' position.

MR. EVANS: Oh yes.

Q. There is also a place in Mr. Gordon's statement in which there is a suggestion that there might be a tendency today for railways to price themselves out of the market. Is there anything in your mind that would suggest that that point has been reached today?

A. In Canada?

Q. Yes?

A. Speaking broadly, or have you reference to certain classes of traffic?

Q. No, I only have reference to the statement that was made in Mr. Gordon's statement and in your answer to Mr. Covert.

A. I do not think that the saturation point has been reached, and the railways are now asking for further increases.



Q. When you said assuming the freight rate structure can stand it, you had not anything specifically in mind that it might have reached that point now where the rate structure could not stand it?

A. No.

COMMISSIONER INNIS: Q. Then the decline in traffic, which you have described, you think is in no way attributable to the increase in rates?

A. Pardon?

Q. The decline in traffic to which you referred this morning is in no way attributable to the increase in rates?

A. That is a difficult a question to answer. I really could not answer that. I have no doubt it has a very small effect, but I think that the decrease in traffic volume generally is due to the decrease in the natural business activity of the country.

MR. EVANS: Q. I was going to suggest this to you -- and I assume we must all recognize it -- that there is motor competition today. I am not thinking of that, but taking a general view of the matter in a period of rising prices and inflation there is very little danger of pricing yourself out of the market so long as your increases are not higher or too much higher than the general increases in the prices of other commodities?

A. As a broad statement I would agree with that, but I think on certain classes of traffic, that which is vulnerable to truck competition, further increases in railway rates would have the effect of pricing you out of the market.

Q. Yes. I gave you the opportunity of putting in the matter of motor truck competition because that is in a special category, and one recognizes that then the test must be perhaps not so much that one prices oneself out of the market



but one prices oneself higher than one's competition will enable you to obtain the traffic, so that one must then consider the costs of operation of one's competitors before one can say that one's rates were too high having regard to the competition. I just wanted to clear up the generality.

COMMISSIONER INNIS: I was just wondering, Mr. Evans, whether you might not very quickly reach a sort of spiral stage. If you begin increasing rates and competition from trucks and otherwise becomes more acute then you begin to need more increases in rates and your traffic goes down. Is there a balance there which is very difficult to maintain?

MR. EVANS: If you were to ask me my view it would be this. Considering it first without the element of truck competition, if it is considered without the element of truck competition then the fact that railway rates have been going up less steeply than other costs have risen would suggest to me the almost impossibility, so long as that condition exists, of pricing oneself out of the market.

If you then take the second step and you suggest that the competitor is something which one must bear in mind, and that competition is becoming more and more acute, increases may have the effect you mentioned. That is a little more difficult problem. You first must consider the increases in the cost of operation of the competitor because he is not immune from these same influences. If you speak of it as something resulting from increased prices forcing railway rates up, with a given level of competition it does not seem to me that in that second event there is much likelihood of pricing yourself out of the market.

There is a third angle, and that is this. If there is great development of highways and increasing development of highway competition irrespective of costs, that in itself may





prove a threat to railway traffic. Therefore my suggestion would be this, that increasing prices of railway services through increased rates in a period of rising prices does not in itself provide any question of pricing out of the market. What does concern us is that the increasing volume of motor competition may result in some necessity of meeting competition at lower rates. Perhaps I am obstruse on that.

COMMISSIONER INNIS: Oh no, that is a fairly simple statement. I was wondering whether it is not too simple.

MR. EVANS: Perhaps it is; perhaps my mind works that way.

COMMISSIONER INNIS: I would have thought that you have a very delicate situation in which a slight falling off in traffic with expenses relatively rigid in the railway business would very quickly get you into the situation where revenue was going down in spite of what you could do towards increases in rates.

MR. EVANS: My suggestion there would be that that is certainly a factor in a period of declining prices and depressed business conditions. That was the position the Interstate Commerce Commission took in the depression period when the railroads asked for increased rates. As a matter of fact, I think it is rather important to notice that in that same period, although both Canadian railways were heavily depressed, no such attempt was made by them, and I rather suggest, without taking too much credit for them, that they might have understood that problem.

COMMISSIONER INNIS: I would think a decline in traffic would be a very alarming situation so far as the railways are concerned with regard to rates as well as with regard to other factors.

MR. EVANS: I think that is perfectly true, and if I may offer this observation, in a question Dr. Angus put to



me the other day I think he pointed it up from my standpoint. He rather suggested this to me - and I hope I am not misquoting you; I know I agreed with you -- that in a period of large volume there probably ought to be recognition by the regulatory tribunal that a company should be allowed to earn rather more than might be considered to be fair on an average basis in order to provide for those periods when depressed conditions exist and when, because of the very reason you put, rates cannot properly be raised.

MR. O'DONNELL: Rate stabilization.

MR. FRAWLEY: The Commissioners will remember --

THE CHAIRMAN: Pardon?

MR. FRAWLEY: The Commissioners will remember that the railways are taking care not to price themselves out of the competitive traffic because none of the 16% increase, the Commissioners will recall, is going on the competitive traffic. All of that 16% increase, which they have recently been awarded, is going on the non-competitive traffic, so they are taking care, of course, as they have to, not to price themselves out of the competitive traffic field.

Therefore they take it all on the non-competitive area and that largely falls on the long haul.

MR. EVANS: Mr. Frawley is, as usual, making far too broad a statement because it is not an accurate statement.

MR. FRAWLEY: Then what is the fact, because I am advised that no part of the 16% has gone on the competitive traffic. Certainly it has not gone on the trans-continental rates.

MR. EVANS: May I make a statement as to what the fact was? In July, 1948, all railway companies joined in an application for an increase of 20%, and they asked for an interim increase of 15%. They did not need the authority



of the Board to put into effect an interim increase of 15% in competitive rates, and they did so without waiting for any hearing. They did so in September of that year.

What my friend is saying --

THE CHAIRMAN: December?

MR. EVANS: September of 1948, almost immediately after the application was filed they put that into effect.

MR. O'DONNELL: It shows on Exhibit 250 that we filed yesterday.

MR. EVANS: Now, as a result of the final determination of that application filed in July, 1948, the Board awarded us 16%, a total increase of 16%. My friend says we did not apply any part of that 16% to competitive rates but he overlooks the fact that we had previously increased competitive rates, without waiting for that judgment, by 15%. Moreover, we have made further increases in other competitive rates, trans-continental rates, and have eliminated entirely other competitive rates. When my friend says that we put the whole burden of these increases on non-competitive traffic he is just saying what is not true.

MR. FRAWLEY: I say you are authorized today to increase your competitive traffic 16%, 8% as of the 23rd day of March and 8% some time ago. As of today, as a matter of fact, they are authorized to increase their competitive rates and they are not doing it.

MR. O'DONNELL: We had previously put them up by 15% and they have come to a point beyond which they cannot go. We have always taken as much as we can get.

MR. FRAWLEY: You are just putting it all on the rest.

MR. MACPHERSON: They put them up 15% after they had received 21% by authority of the Board on long haul





traffic.

MR. EVANS: Mr. MacPherson is again making a misstatement. Mr. MacPherson knows better than the inference he derives from that statement. We put all rates up 21%, including competitive rates. Moreover, in the fall of that same year we increased competitive rates independently by another 15%.

MR. MACPHERSON: It shows you how low they go.

MR. FRAWLEY: It is all very germane to this matter of pricing them out of the market; that is all.

(Page 18981 follows)



MR EVANS: Q. Now, Mr. Cooper, could we return to the subject in which both of us are perhaps more interested? Perhaps I should, I hope without risk of stirring up this controversy again with our friends---

A. About pricing out of the market?

Q. Yes. May I refer to page---

A. May I say this, then, Mr. Evans, that you have advanced this matter so far that you have priced me out of the market, and I am now over with Mr. Fairweather.

Q. Well, if you feel that I should pursue that with Mr. Fairweather, I am quite content to do so.

A. I do, yes.

MR FRAWLEY: Stormy weather and fair weather.

MR EVANS: I think we have been very happy until you interjected, Mr. Frawley.

Q. Now, at page 18705, Mr. Cooper, you renewed the statement made in the brief, and I think in Mr. Gordon's evidence, that 40 per cent of the cost of building branch or development lines should be provided by the Government as equity capital. Now, I am not going to ask you to get into Mr. Fairweather's field there, because I understand that Mr. Fairweather is going to define what are development lines and what are considered to be other than development lines; but in the circumstances in which that was mentioned, I just wanted to ask you whether, if that practice were followed, it would be part of the proposal of the Canadian National that that addition to equity capital resulting from the building of these branch lines would also be entitled to a return?

A. Yes, in the same way that the rest of the---

Q. You were not differentiating in any sense?

A. No.

Q. Perhaps this is for Mr. Fairweather, but you could



tell me if it is: Are you differentiating in your mind between what have been called development lines and branch lines generally?

A. Yes.

THE CHAIRMAN: Between development lines and what?

MR EVANS: Branch lines generally.

THE WITNESS: Any new branch line I think would be a development line.

MR EVANS: Q. Any new branch line?

A. Yes.

Q. That is what I meant. You are not making a difference in your thinking as regards new lines between what might be called a branch line or what might be called a development line?

A. I may be wrong, but I think any branch line built from now on would be a development line.

Q. No matter in what territory it should be built?

A. Yes.

THE CHAIRMAN: Q. With respect to those lines, the statement by Mr. Gordon says that hereafter the company should be free to build or not to build; isn't that so?

A. Yes, sir; he is quite emphatic about that.

MR EVANS: Q. Is it part of your thinking as an accounting officer that the capital fund of \$300 million would be the source from which the funds for the 40 per cent would be derived?

A. No.

Q. It is not?

A. No. The \$300 million is definitely related to a relief of fixed charges.

Q. I see; because there is a suggestion in the brief -- and I think I am right -- or in Mr. Gordon's statement, that that was to be available to be drawn down for capital pur-





poses. I just want to clear it up, because, you see, at page 15 of Mr. Gordon's statement, after describing how this would be set up:

"This would be set up in the accounts of Canadian National as a capital fund to be drawn on from time to time to retire interest-bearing obligations in the hands of the public or for capital additions to the property."

Now, I interpreted capital additions to be other capital additions than those that are termed non-revenue producing additions and betterments?

A. I think maybe I should correct my answer on that. I would be inclined to think that all capital additions and betterments in the next say five years, and all debt redemptions in the next five years, would be financed out of this \$300 million, and that when that point has been reached you come to the requirement that 40 per cent of new branch line construction should be provided by the Government in the way of equity capital.

Q. I just want to carry this one further stage. The 40 per cent which the Government would have in the form of equity capital would be taken out of the fund, but what about the 60 per cent?

A. All capital expenditures in the next five years would come out of the fund.

Q. I see; including the 60 per cent?

A. Yes, sir.

Q. So that the total cost of your branch line construction would then not add to your fixed charges?

A. That is so.

Q. They would then be translated into equity capital as they are made?

A. Yes.



Q. But with the upper limit of your \$300 million in any case?

A. Yes.

Q. Would it be your view that that fund would operate so as to make it unnecessary for the Canadian National to have a special appropriation under section 21 of its Act?

A. What is section 21?

Q. Section 21 is the one that Mr. O'Donnell read yesterday, which authorizes the construction of branch lines.

A. Any branch line now, I think, gets into our annual budget, and what we have in mind here is---

Q. Perhaps I can get my point more clearly to you if I were to read this section to you. Section 21 of the statute, chapter 172 of the Revised Statutes of Canada 1927, I assume, reads as follows:

"With the approval of the Governor in Council and upon any location sanctioned by the Minister of Railways and Canals the Company may from time to time construct and operate railway lines, branches and extensions, or railway facilities or properties of any description in respect to the construction whereof respectively, Parliament may hereafter authorize the necessary expenditure, or the guarantee of an issue of the Company's securities."

And what I am asking you there is, would it be a part of the proposal for the use of that \$300 million fund that that would take the place of the authorization by Parliament of the necessary expenditure?

A. No.

Q. You would have an individual authorization before you draw down out of the fund?

A. Yes.



MR O'DONNELL: There is no intention to amend section 21.

THE CHAIRMAN: I beg your pardon, Mr. O'Donnell?

MR O'DONNELL: I say there is no intention to amend section 21. I think that is what my friend has in mind.

MR EVANS: Well, except this -- and perhaps there ought to be no doubt about it -- that if Parliament should vote that \$300 million as an expenditure, it could perhaps be drawn down at the will of the Canadian National without again resorting to Parliament.

Q. But that is not part of your proposal?

A. No, sir.

MR O'DONNELL: No, I do not think that is quite the way it should be put. Under the Act, section 21, we must go to Parliament to get the authorization; there is no question about that.

THE CHAIRMAN: The language you use is that this money, this fund, would be set up in the accounts of Canadian National as a capital fund to be drawn on from time to time to retire interest-bearing obligations in the hands of the public or for capital additions to the property. Bearing that language in mind, Mr. Evans, what questions arise?

MR EVANS: Well, the section which I read, section 21 of the Act, requires Parliament to appropriate the money necessary for the building of a branch line, and what I was enquiring from Mr. Cooper was whether it was part of their proposal that once Parliament voted this \$300 million capital fund it would be again necessary to their proposal to go under section 21 for a special appropriation for the building of a branch line. The point I make about it -- and I am being perfectly frank with my friends -- is that it would be





a very considerable advantage to our competitor if that could be done, because they have this special legislation which requires merely an Order in Council and a location approved by the Minister, and if all this capital fund could be used in building branch lines it would, I would suggest, be a threat to have no annual parliamentary authority for each line.

THE CHAIRMAN: Again we are on the question of intention.

MR EVANS: No, I think---

THE CHAIRMAN: Mr. O'Donnell, what relation do you place between this paragraph 2 on page 15 and the fund therein specified, and section 21?

MR O'DONNELL: None at all, my lord; I do not place any relationship at all between it, and I am satisfied there is no intention to endeavour to alter the express provision of section 21. Section 21 says that we must obtain the authorization of Parliament before we can proceed with the construction of any of the railway lines, branches or extensions referred to in section 21. There is no intention to alter that.

THE CHAIRMAN: We are about to adjourn for lunch. Would it save some time if I asked you just now, Mr. O'Donnell, in further reference to section 21, to read with it section 12? You see, I have been trying to get at what is this Canadian National Railways, what is the core of it. The language used would seem always to indicate, here is the Canadian National Railway, something in itself, and it has been made to do this and made to do that, and made to acquire unprofitable lines, made to build developmental lines, and so on. Now, in section 12 I find this language:

"The Company may, in respect of the operation of its lines of railway or the lines of railway of the



Canadian Northern System or the Canadian Government Railways"

do so-and-so. That would seem to indicate that there are three classes of railway there -- the company's own railways and the Canadian Northern System, which is brought into it, and the Canadian Government Railways. I would like if later---

MR O'DONNELL: My lord, in order to understand that, there are six or seven Orders in Council which tie in with the statute.

THE CHAIRMAN: We might clear it up later.

MR O'DONNELL: Yes.

---The Commission adjourned at 1:00 p.m., to meet again at 2:45 p.m.



Ottawa, Ontario,  
March 23, 1950.

AFTERNOON SESSION

T. H. COOPER, Recalled

CROSS-EXAMINATION CONT'D BY MR EVANS:

Q. I think at the adjournment, Mr. Cooper, we had been discussing the use of the capital fund for branch line construction or development lines, and from that I wanted to pass to a statement made on page 18379 in support of the reduction in the fixed charges on the ground of widely fluctuating earning power.

THE CHAIRMAN: A statement by whom? By Mr. Cooper?

MR EVANS: It was Mr. Gordon's statement, Mr. Chairman.

Q. You will see at the top of page 18379 a statement about the future earnings of the property, and it is stated there:

"It is conceivable that in some years the property would do no better than meet its operating expenses. In good times it would be reasonable to expect fairly substantial earnings."

Then it is said:

"For a property having these characteristics, it would be logical . . ."

I just point out that the statement there made is rather a suggestion that the characteristics of your property are such that earning power fluctuates, perhaps more widely than normally would be expected in the case of other railways, and that that was to be taken into account in the assessment of the propriety of your proposals. Now, all I want to put to you about that is, would you not agree that, apart perhaps from the matter of degree, that is





also true of the Canadian Pacific?

A. Definitely. I think in the main brief -- perhaps not, but I remember quite well that in 1933, for example, our gross earnings dropped to \$148 million, which was approximately one half of what they were in 1929, and by looking up the records of the Canadian Pacific I saw that percentagewise your revenues were just about in the same proportion that ours were, and also the same thing was true of the Class I railroads.

THE CHAIRMAN: Q. Of the what?

A. The Class I railways.

MR EVANS: Q. Now, if I could go this far with this subject of the use of surplus earnings without transgressing on Mr. Fairweather's territory, I assume that as an accounting officer of the front rank, Mr. Cooper, you would have views as to how the stabilization fund would be resorted to -- for example, what would be considered poor years, so as to justify drawing down from the fund some part of the funds in it. Would that not be a fair assumption, as an accounting officer?

A. I have not taken very seriously the idea that we would ever build up a large surplus fund, Mr. Evans. I cannot visualize that the net earnings of the Canadian National Railways will ever be in substantial figures, and if out of the surplus we are to first take the improvements and then whatever is left or a portion of whatever is left is put into this fund, then if we have a deficit we shall draw on the fund. I cannot visualize ever building up a fund of any size. I do not consider this matter is very important at all.

Q. Well, as an accounting officer, though, I think it would be fair to suggest -- both as an accounting officer and as a vice-president -- your views would be available



and would be considered of importance in deciding whether in a given condition the fund would be drawn upon?

A. Yes, I think they would ask my opinion.

Q. I would think so.

A. Yes.

Q. Because actually as the accounting officer it would be some responsibility of yours to see that the conditions under which the fund was established were fulfilled in putting money into it and taking money out of it?

A. It would be a very definite responsibility.

Q. I do not put it any higher than that. Now, still trying not to transgress on Mr. Fairweather's territory, I merely want to suggest to you this: Would that be a fund in the sense of the term in which you would have money set aside and invested, or would it be an earmarked reserve?

A. I would think it would be a fund.

Q. It would be a fund?

A. I think so, because -- if I could complete that?

Q. Yes.

A. If it were not in funds, and we had a deficit and we had to meet that deficit out of a reserve, that would not go very far, would it?

Q. I am inclined to agree with you, but I wanted to see what your view was. Perhaps you remember, as I do, the way in which the Montreal budget was balanced by---

THE CHAIRMAN: The Montreal what?

MR EVANS: The Montreal budget was balanced by resorting to so-called surpluses accumulated in respect of previous years.

Q. You would not have anything of that kind in your mind?

A. I really do not know what you are referring to.



MR O'DONNELL: That is higher finance than we are used to.

MR EVANS: Q. To put it perfectly clearly, you see what I mean when I say, if it is a fund the money is there, and invested presumably; if it is a reserve earmarked merely for special purposes, the funds would be released which could be used for investment in the property or for reduction of debt and so on?

A. Yes. Then my answer to that is that it would be a fund as distinguished from a reserve.

THE CHAIRMAN: Yes, but we must take that in connection with its purposes.

MR EVANS: Oh, quite.. I am not distinguishing purposes at the moment; I am distinguishing between a fund and a reserve, both having the same purposes.

THE CHAIRMAN: Well, what is it called? Is it not called a stabilization fund?

MR EVANS: It is called a fund; it is called a fund, but I wanted to get it clear on the record.

THE CHAIRMAN: To establish a stabilization fund.

MR O'DONNELL: And the first sentence speaks of the establishment of reserves.

COMMISSIONER ANGUS: Is it not described as a fund which was to be part of a reserve?

MR O'DONNELL: Yes.

THE CHAIRMAN: It is to be drawn upon in poor years with the view of affording stability to the rate structure and tending, to the extent of the fund from time to time existing, to postpone the necessity of applications for general freight rate increases. I think that requires a lot of explanation.

COMMISSIONER INNIS: You would not favour the extension of that idea? Not thinking of the C.N., but





extending it to the C.P., so that there was a common sort of fund which was---

MR EVANS: Well, I was going to put that question in due course to Mr. Cooper. It gets down to this, Dr. Innis, does it not, that as far as the Canadian Pacific is concerned it must earn its fixed charges, its dividend requirements and its surplus requirements, and if the permissible earning power should be such that there could be a stabilization fund I think that would meet the problem posed to me the other day by Dr. Angus, that you might thereby be able to provide a stabilization fund for taking care of the lower traffic years and so-called poor years; but you must first, I think, have in mind that a privately-owned corporation cannot just appropriate what it likes out of surplus for that purpose; it must have something over and above what its immediate requirements are, and that, I think, is perhaps the way I would point out what we fear in the way this proposal is made.

COMMISSIONER INNIS: Well, it would be intolerable to have it in the hands of one railroad and not in the other.

MR EVANS: Yes; and particularly if one railroad which was publicly owned can resort to a fund without fear that if it did resort to it and had a deficit that it could not meet it could go to the Government for relief; it would be very difficult for a private corporation to meet that, and it is to protect against that that I am concerning myself.

MR O'DONNELL: I might possibly say this: It occurs to me that in so far as this particular fund is concerned, or this reserve that is referred to under that heading of surplus earnings, it is really at this point nothing but a matter of internal management so far as the Canadian National is concerned. At the present time, as I understand



it, Canadian Pacific is perfectly free to do those two things, provide out of surplus earnings a reserve to take care of expenditures for producing improvements and betterments -- and my friend frankly said this morning that does not bother him; he can do that. He can also do the next thing if he wants to, which is to set up a reserve for the purpose that is expressed there, to be built up in good years and drawn on in bad years. They are free to do that.

THE CHAIRMAN: What is the meaning of this, Mr. O'Donnell, that this fund is to be used with the view of affording stability to the rate structure?

MR O'DONNELL: Well, in so far as the Canadian National is concerned, it is free at any time, even as is the Canadian Pacific, to apply for a rate increase if it thinks it should so do. The history has been lately, in the last number of years in any event, that the application has been made usually through the Railway Association, but all railways are free to make their own individual application if they so choose. Our road suggests here that if we have any surplus -- and it is unlikely, as Mr. Cooper says, that it will ever get to anything, even with this adjustment that is asked for in the first part of Mr. Gordon's statement; even if that adjustment be made, it is scarcely likely that there would be any substantial surplus in so far as we can see. If there were, it would only be by reason of the fact that the rates established as they have been heretofore, on the basis of the Canadian Pacific's requirements, would provide a surplus, would provide something over and above. Now, if it provided it for the Canadian National it would have provided it for the Canadian Pacific. All the Canadian National is asking here is this, that this Commission recommend that some consideration be given to that way of handling any surplus that may be in existence at any time.



Now, in order to understand the reason for that, I think I should say this, possibly: It gets to the relationship between the Canadian National and the Government. I read this morning the section of the Canadian National Railways Capital Revision Act, section 10, which dealt with the surplus earnings and how they had to be handled.

(Page 18996 follows)





Section 10 is very brief and I might just read it again.

THE CHAIRMAN: Pardon me a moment. I want to make sure that I have that Act here. What year was it?

MR. O'DONNELL: That was 1937, my lord; Capital Revision Act, Chapter 22, I George VI.

THE CHAIRMAN: I do not seem to have it. However, do not wait for me. If you will read it to us, we will get on.

MR. O'DONNELL: Section 10, reads as follows:-

"10. Whenever the accounts of the National Railway System certified by the auditors appointed by Parliament show surplus earnings after the payment of all charges including interest on securities held by the public, the directors of the Canadian National Railway Company may cause to be paid over to the Minister for the Consolidated Revenue Fund all or any part of any such surplus earnings."

That is the situation under the Statute.

THE CHAIRMAN: And you want the Statute changed?

MR. O'DONNELL: We do not want the Statute changed. Insofar as I am concerned, the Statute is quite clear.

But the understanding of the relationship between the Government and the Railway has to be made clear in order that the position be properly comprehended.

The situation has been that in the past the practice has been to pay over to the Crown immediately following the conclusion of any calendar year whatever surpluses may have been accrued during that preceding year.



THE CHAIRMAN: Is that without using anything for betterments and so on?

MR. O'DONNELL: Any surplus which they may have after they pay all charges, including the interest on securities held by the public.

THE CHAIRMAN: That is all?

MR. O'DONNELL: That is all. And in practice what they have done was to pay it over, although they do have that discretionary power as to "all or any part" of the earned surplus.

All the earned surplus went to the Crown and that was by reason of the fact that the railway owed the Government as much money as it did. They had no choice really in handling that surplus, and it was turned over on midnight December 31, at the end of the year. It went over to the Crown.

We have asked at this point to have that interest-bearing debt converted into equity capital, and there is a possibility, in the circumstances, that there may be a little more surplus than there previously was. What the directors are asking is not that the Statute be amended.

THE CHAIRMAN: To whom would we make our recommendation?

MR. O'DONNELL: It would be, I assume, in your report.

THE CHAIRMAN: But if they have the power to do this thing anyhow?

MR. O'DONNELL: By reason of the practice which has existed in the past, they ask for a recommendation that they be allowed to hold all or any part.

THE CHAIRMAN: Allowed by whom? By Parliament



or by the Cabinet?

MR. O'DONNELL: By the Government.

THE CHAIRMAN: Then our recommendation would be addressed to the Government?

MR. O'DONNELL: Your recommendation as contained in the report of the Royal Commission when it is returned would be that you report and recommend what you think is reasonable.

In the circumstances now the Canadian National management is firmly of the opinion that prudent administration, as Mr. Gordon says, of the property requires that reserves be established in good years, to be drawn on in lean years.

And it is for that reason that they would like that recommendation from the Commission, that, in the exercise of their discretionary powers in the future, the Board give consideration to the matter of providing funds for these two purposes, the purpose of providing these additions and betterments to the railway, and also the purpose of providing a cushion that could be drawn on in poor years, insofar as rates are concerned.

THE CHAIRMAN: I see all that. But Section 10 supposes a surplus, the very thing which Mr. Gordon supposed here.

MR. O'DONNELL: Yes.

THE CHAIRMAN: The same surplus arrived at in the same way?

MR. O'DONNELL: Yes.

THE CHAIRMAN: And Section 10 says that the Company:-

"....may cause to be paid over to the  
Minister for the Consolidated Revenue Fund





"all or any part of any such surplus earnings."

MR. O'DONNELL: That is right.

THE CHAIRMAN: But what happens if they do not cause to be turned over all or any part? Has that ever occurred?

MR. O'DONNELL: No, I do not think it has ever occurred, and it is by reason of the past practice that they ask these things be permitted in the future.

THE CHAIRMAN: You think they require some authority?

MR. O'DONNELL: No, I do not think so. I think the Statute gives that authority.

THE CHAIRMAN: Section 10 says:- "may cause". I suppose "may not" can be inferred; that they may or may not pay over the whole or any part to the Government?

MR. O'DONNELL: That is right.

THE CHAIRMAN: And otherwise, I suppose, they are free?

MR. O'DONNELL: Today they are absolutely free to set up those two reserve funds, without any request or recommendation. That would be my candid view; and I think my good friends of the Canadian Pacific could do it as well, if they so chose.

THE CHAIRMAN: Would you go so far as to say - I know this question would require consideration and I don't want to force you into a snap answer - but would it be all right to withdraw this contentious part of Mr. Gordon's statement, and to leave the Act as it is?

MR. O'DONNELL: That is something we could consider, and it might remove a lot of discussion, and dissipate fears which, in my view, are not well founded.

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THE CHAIRMAN: Apparently the Board of your Company thought that there ought to be something done about it.

MR. O'DONNELL: Because there was some doubt about Section 10.

THE CHAIRMAN: Can we hear from You again?

MR. O'DONNELL: I will do that. And I think that possibly would be the way to handle the thing and not bother the Commission with it.

THE CHAIRMAN: When the Statute is satisfactory the way it is, I think it would be much better not to add to it.

MR. O'DONNELL: I think so too; and I think that if the directors today wished to retain every cent of surplus, they are free to do it; and I think that is something which the Canadian Pacific, and any other railway in Canada is likewise free to do.

THE CHAIRMAN: You cannot expect us to make a recommendation and then to be told; That is all ready in the Act.

MR. O'DONNELL: I can quite understand that, my lord, but sometimes one has to act under instructions.

However, my frank view is that we can do that today, and that it would clarify the situation for us to act as you have suggested.

THE CHAIRMAN: Then we are to hear from you again, definitely in time for Mr. Evans to cross-examine on it, if he should still deem it necessary?

MR. O'DONNELL: Yes, my lord. I will make a point of doing that promptly.

MR. EVANS: I do think I ought to say this in

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fairness to my friends and in fairness to the Commission.

First, may I say that undoubtedly the Canadian Pacific should establish such a fund .

THE CHAIRMAN: Yes.

MR. EVANS: And the only limitation upon the Canadian Pacific's ability to do that is to get sufficient revenue to do it.

Now then, the consideration to which my friend refers is this: he rather suggests that all this means is the power to set up such a fund.

Now then, I do not question his sincerity in that statement one particle. But I say this to the Commission: if they have the power today to set up such a fund and if, through the recapitalization which they propose, that power can be exercised so as to provide such a fund, then I think this Commission ought to see, by appropriate conditions, that that power, which involves the use of a fund set up only after a reduced level of fixed charges, shall not be exercised so as to imperil the financial position of the Canadian Pacific.

Now, I shall have express and explicit views to offer in due course on that subject, but I do not think my friend quite appreciates the problem that I have.

If this is a proposal, whether or not it is within the power of the Company to do it today, it is the fact that the power may be exercised as a result of what takes place in reducing the application to the Canadian National, that constitutes a threat to the Canadian Pacific.

Perhaps I have not made myself quite clear?

THE CHAIRMAN: Yes, I understand.





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MR. EVANS: But it is the fact that I have no objection to the Canadian National getting relief from fixed charges. But if that relief is construed to permit all the money they may make, after they reduce the fixed charges, to be used, first, for this capital fund, with which I have no quarrel, and secondly, for rate stabilization purposes, then, as I am about to go into with the witness, in the years in which they do earn a very large surplus, that can, without a positive protection, afford this difficulty.

What I am asking for is a positive protection and not a negative protection, if I make myself clear. And I think my friend Mr. O'Donnell perhaps has not quite appreciated the position I put.

MR. O'DONNELL: I think I quite appreciate the position, and I think that my friend's fears are undoubtedly unfounded. I do not think that they loom as large, in fact, as he seems to think in fact they do.

Surely the Canadian National should not be precluded, I should think, in the circumstances, from using any surplus which it may have as the proceeds of a just and reasonable rate previously fixed by the Board and heretofore fixed, and as at this date fixed, by the Board on the basis of the Canadian Pacific Railway.

MR. EVANS: I agree with you.

MR. O'DONNELL: We have not asked for that basis to be changed.

MR. EVANS: I agree.

MR. O'DONNELL: We have made no submission that the Canadian National should be the yardstick.

I pointed that out yesterday two or three times. And



that being the case, if as a result of its using whatever basis the Board chooses to establish - and heretofore it has been on the basis of the Canadian Pacific's requirements - some monies flow into the till of the Canadian National Railways - -

THE CHAIRMAN: You expect that to happen?

MR. O'DONNELL: I do not know. It may be that in some years we can expect a surplus and in other years a deficit. But in any year that we happen to have a surplus it is suggested we could use some part of it as we today could without any objection, for these two purposes.

THE CHAIRMAN: That is all right. If you already have the power to do that under Section 10. I do not see how it restricts you there.

Does your objection go that far, Mr. Evans, that Section 10 should be amended?

MR. EVANS: No, sir.

THE CHAIRMAN: You would leave it as it is?

MR. EVANS: I have not thought of Section 10 at all. May I state my position?

THE CHAIRMAN: Mr. O'Donnell is asking for this thing which you find to be a bit dangerous, as far as you are concerned - I mean Mr. Gordon's statement on page 17 - and then Mr. O'Donnell says we do not need that anyhow because we already have that power under Section 10.

MR. EVANS: Yes.

THE CHAIRMAN: And you are looking forward, as I know he is, to the Canadian National's providing greater earnings in the future than it has in the past, are your fears not sufficient to carry you into questioning about what the Company may do under Section 10?

MR EVANS: It is not Section 10 which is in my mind.



THE CHAIRMAN: I know, but I say if he abandons what is on page 16, the surplus earnings paragraph, then he comes back to section 10. Now then, section 10 says that in the case of such a surplus the <sup>Company</sup> may pay over the whole of it or part of it to the Government.

MR EVANS: Yes sir.

THE CHAIRMAN: There is no obligation, you see. It is a "may". Then they would have that same surplus whether or not page 16 of Mr. Gordon's statement is followed. Then under section 10, if the surplus is large enough, they can build up this fund. Then you would let them do that, is that the idea?

MR EVANS: If I may be permitted to express myself, sir, you see, the way section 10 operates today is that section 10 deals with surpluses after fixed charges.

THE CHAIRMAN: Yes.

MR EVANS: Which are now on a level of about \$46 million a year. Now then, I am quite prepared to concede without expressing any opinion one way or another, that some relief from the burden of fixed charges may be required. What I say is this. If there is relief then one must think of what will take place in years in which the earnings would have been sufficient to pay that level of fixed charges, would have been sufficient to provide a very large surplus.

Now then, I say that in those years those large surplus earnings might properly be paid as a return to the equity stock holder, the Government. Unless that is done, that is in those years of large earnings (which I don't think are as far removed from possibility as our friends





as our friends think) in those years that fund could be built up and could prevent increases in freight rates which are necessary to keep us alive.

Now, you see, it doesn't make any difference whether they ask that section 10 be amended or not. I say that as a condition of the revision of the capital structure you should do one of two things. One, the statute which they had to have, to have the provision, should so provide: (a) the Canadian Pacific should not have its requirements overlooked, or (b) that the Canadian National Railway Company should be allowed to earn a return on the equity capital. I don't say it should be required to, but should be allowed to, before it can be used as a weapon to get rates reduced. I don't care whether they have got power to do it today or not. It makes no difference.

THE CHAIRMAN: If it is only to be allowed to, are you getting any further ahead?

MR EVANS: Oh, yes,

the CHAIRMAN: Are you?

MR EVANS: Yes. I quite see my friend Mr Cooper's position. He says: "I don't want to be compelled to earn this money to meet these fixed charges. It is odious to me to be faced day after day with deficits which are represented by fixed charges which I cannot regularly earn." Now, I am taking a sympathetic position; I don't know what the real situation is but I am prepared to take the sympathetic view that that may be true and relief may be necessary. But I say: Don't overlook <sup>that</sup> the possibility/you may have earnings, even the possibility of earnings, which then should be available to the equity security holders.

THE CHAIRMAN: Should be?



MR EVANS: Yes, and not to build up a fund for so-called rate stabilization purposes. I don't care whether they have got the power to do it or not. Once the changed capital structure makes it possible, then I say protection should be given.

COMMISSIONER ANGUS: But with either of your hypotheses one would have to amend section 10 to some extent I suppose?

MR EVANS: Well, they will have to amend this Act to get this capitalization done.

THE CHAIRMAN: You see, section 10 in itself is a capitalization act. Is it not the Railway Act, it is not the Canadian National Act itself: it is a revision act.

MR EVANS: They will have to have some legislation and whatever legislation they have---

THE CHAIRMAN: Did I understand you to say that the legislation should provide that it must take care of this equity stock?

MR EVANS: If there are earnings.

THE CHAIRMAN: Yes, before they can have a surplus.

MR EVANS: Before they can have the kind of surplus that could affect a rate stabilization fund.

THE CHAIRMAN: Then you do want some provision to that effect.

MR EVANS: Oh, yes, very definitely.

MR O'DONNELL: As Dr. Innis suggested if everybody had some kind of fund that would possibly take care of the trouble.

COMMISSIONER INNIS: I think there are two points there. There is one - and I am not sure that



Mr. Evans would agree. If you were to complain if the C.P.R. were to build up a fund (and I see no reason why you should not complain just as the C.P.R. would complain of your building up a fund) after all it is going to affect your position and the railway structure. Then there is the other problem ( and I am sure Mr. MacPherson will speak about it) that the Provinces have a very important stake in whatever policy is being followed.

MR MacPHERSON: That, Mr. Chairman, was just what I was going to say. I have listened with a great deal of interest to the discussion between our friends of the railways, and I just wish to say a word from the standpoint of the shipper as I think ultimately this matter must affect him. This fund which is apparently so innocent and which was intended to achieve something very splendid in the matter of controlling the freight rate structure, after all, after the discussion we have had here, just how in the last analysis is it going to affect the shipper? If the Canadian National has it and establishes it, then the Canadian Pacific will have it tomorrow or try to have it and establish it. And so far as the shipper is concerned in respect of the establishment, there will be ultimately a need or requirement of the railway established.

THE CHAIRMAN: A requirement of what?

MR MacPHERSON: A need or a requirement. This fund, the existence of this fund, will be something that will be required. In railway policy as testified and as Mr. Cooper very frankly stated yesterday, in the long run freight carries the load. That is consequently why as a shipper and on behalf of the shippers---

THE CHAIRMAN: You are afraid of applications





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to increase freight rates necessary to build up a fund to keep them down.

MR MacPHERSON: Exactly my point. I mean, we only have to go through the recent history of the railways. It is only so recent, according to evidence that has come out here, that the one railway started depreciation accounting and the other does likewise. They both have it. One sets up a deferred maintenance fund and the other does. I am not complaining of that, but I am saying that by the same token if this sort of fund is established by one company it is going to be established by the other, and in the long run it will be the shipper that pays. Consequently however well intentioned the idea of this fund may have been, I think that the shipper must be the man who in the last place must investigate most carefully just how it is going to affect him. And I fear it notwithstanding the very desirable suggestion that is made that it is for the purpose of controlling the freight rate structure.

MR FRAWLEY: Mr. Chairman, I put it a little more bluntly. Mr. Evans fears Mr. O'Donnell, but I fear Mr. Evans. Mr. Evans is at the moment the rate-making railway, and he says very glibly: "Oh, yes, I don't doubt at all that we, the Canadian Pacific, could set up such a fund".

MR EVANS: I don't say that at all.

MR FRAWLEY: I challenge that completely. The Canadian Pacific today could not set up a fund for the purpose of postponing the necessity of applications for general freight rate increases. They are a regulated body. The Board of Transport Commissioners would have to say; "What is going into that fund, where is the money coming from?".



It could be put very simply this way, if I understand it, although I think we are all very impolite not to wait until Mr. Fairweather tells us what it is intended to do; but Mr. Evans is trying to say that he thinks he may have, and this is why he may have one, that it might be hard to investigate. To put it bluntly, he would be charging today so that he would not have to charge too much ten years from now or two or three years from now. I object to that.

My company may be out of existence in two years but I will be paying charges today. In the natural course of my company it might have worked out its existence in two years, but my level of freight rates would be too much to carry my traffic today, but not too much on the basis that it is going to help carry some traffic that may not originate until three years from now.

Now, in anticipation of what Mr. Fairweather says as to how this rate stabilization fund might work out, I challenge firstly the right of the railway to build up any such fund, because all they are entitled to do is to have sufficient money to charge fair and reasonable rates as of today - not as of some day in the future. I just wanted to go on the record as challenging the right of the rate-making railway, the Canadian Pacific, to set up such a fund.

MR O'DONNELL: It is only on the surplus earnings.

MR FRAWLEY: Then let the surplus earnings go to rebate the the freight rates.

MR O'DONNELL: I would suggest that what is done with surplus earnings which have only been obtained after the just and reasonable rate has been set and fixed, what the owners of the surplus earnings may do with them must be their business.

MR FRAWLEY: Too much their business.



MR O'DONNELL: It cannot be too much -- to the extent that there are any surplus earnings, that this fund could be set up. Now, what the railways do with their surplus earning, their justified and legal surplus earnings as allowed to them through the rates as controlled and fixed by the Board of Transport Commissioners, surely must be their affair. Now, we would only have a surplus or surplus earnings today on the basis that just and reasonable rates had been fixed by the Board on the basis of the requirements of the Canadian Pacific Railway. That is the way it stands today.

Now, if we have any surplus earnings after the rate has been fixed on their requirements and we have something left, we ought to be free to handle that as we see fit, and that is all that is suggested.

Now, it may be in the final analysis, my lord, that this having created a certain amount of interest, probably the best way to deal with it is rather as your lordship has suggested, that after we have heard Mr. Fairweather and I have information from my people--

COMMISSIONER ANGUS: Isn't there some danger in the way in which you use just and reasonable rates, of begging the question, because the rates are just and reasonable if they give a certain return to the Canadian Pacific Railway?

MR O'DONNELL: That is right today.

COMMISSIONER ANGUS: And you say that out of these just and reasonable rates a surplus might be built up.

MR O'DONNELL: Yes.

COMMISSIONER ANGUS: Now, the question would be, are just and reasonable rates rates which would include that surplus which would enable it to be built up; or are they the





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rates which would exclude it? Now, if you say just and reasonable rates are rates fixed by the Board and are therefore just and reasonable, that is a truism, that is a proposition in terms in the legal meaning of the word. But if you say that just and reasonable rates are in some way the proper or right rates according to any test, then the rates fixed by the Board are themselves open to question. Somebody could come and say that these rates are not just and reasonable today because something has happened, and if the fund were allowed, would not rates which have been just and reasonable before it was instituted <sup>cease</sup> to be just and reasonable and a higher rate be required for that test of justice and reasonableness?

MR O'DONNELL: As I understand that question the Board of Transport Commissioners has a continuing day-to-day control over the rates, and the Board has fixed rates on the basis of the financial requirements of the Canadian Pacific Railway. We have asked for no change in that before this Commission; there is no submission that that be changed. Now, these rates have been fixed on this basis, that the financial requirements of the Canadian Pacific Railways are their operating expenses, their fixed charges, their reasonable dividends and a reasonable surplus.

COMMISSIONER ANGUS: Including this type of surplus?

MR O'DONNELL: Yes, in the broad sense, and all I am saying is when I come to deal with my surplus,, which we may have after those things have been provided for on the basis of the Canadian Pacific Railway - if there is any surplus, and the surplus has usually been something in the neighborhood of half of the going money rate., something of that kind, (w are talking about no huge sum, I don't



think in the final analysis) but if a surplus is to be permitted by the Board of Transport Commissioners, is to continue to be allowed, a reasonable surplus, (I don't think anyone will question that) then that reasonable surplus getting into the exchequer of the Canadian Pacific or into our till, belongs to the railroads, and may be used freely by the Canadian Pacific as it chooses to use it.

(Page 19020 follows)



It is not an additional amount that we are asking for. I would like to clarify that. We are not asking for an additional factor in the rate to provide this so-called surplus. We are merely asking that the surplus---

COMMISSIONER ANGUS: As I understand Mr. Evans' point, it is really this, that the test in accordance with which the Canadian Pacific Railway gets a relatively small surplus might under certain circumstances give you a relatively big one, and then he is afraid of the drag of that big one on the future rates.

MR O'DONNELL: Well, if that arose, would not the situation have to be switched then? And possibly there would have to be an adjustment of rates on another basis, because on that basis the Canadian Pacific would still be the yardstick, and I am not asking that that be changed, so that I can only get the relative amount that the Canadian Pacific requirements permit me to have.

COMMISSIONER ANGUS: If there is a contingency in which the basis must be changed of fixing rates, surely any recommendation that we make must take account of that contingency.

MR O'DONNELL: Yes.

COMMISSIONER ANGUS: If that is involved, one would want some explanation of it and some recommendation about it.

MR FRAWLEY: Dr. Angus, in support of what you have been saying, I think that if you look at page 26 of the judgment of the Board of Transport Commissioners in the 30% Case you will see there precisely what this surplus, this so-called surplus, was in the beginning when it was first requested by the Canadian Pacific Railway. It was then \$15,235,000, and, strange to relate, it still remains since 1946, it still remains the surplus that they wish and





request.

"The Canadian Pacific Railway Company did not furnish particulars of how the amount of \$15,235,000 asked for Additions and Betterments to Railway Property (Net after Retirements)' was made up. The company assumed that the expenditures on this account for 1947 would be no less than they were established to be in 1946. No detailed estimates were made. On the other hand, the Canadian National Railways, in their Exhibit 187, give the detailed items which go to make up the \$16,777,000 which they ask to be allowed as a requirement for additions and betterments."

It is quite true that the Board went on and said, "We will not give them this \$15,235,000 as additions and betterments net after retirements. We prefer to say they should have something by way of a surplus." Fine -- but nevertheless the railway came to the Board in 1946 and asked for \$15,235,000 for additions and betterments to railway property net after retirements. I say, in support of what I said a few moments ago, that nothing in that ever was intended to go into a fund of this kind, to charge me too much today so they won't have to charge me too much five years from now.

COMMISSIONER INNIS: Suppose the Commission were to find, after studying the problem from various angles, that the C.P.R. should not be the yardstick; what would be the position of your surplus earnings?

MR O'DONNELL: What would be the position of our surplus earnings?

COMMISSIONER INNIS: As it is worked out in this statement.

MR O'DONNELL: You mean on Mr. Gordon's submission?



COMMISSIONER INNIS: Yes.

MR O'DONNELL: Well, if we had any surplus earnings we would be allowed to use them to the extent that the directors thought it was right to provide additions and betterments and put a cushion aside for the bad years, and then pay over to the Government under section 10 whatever we might have. There is no intention in so far as this surplus is concerned -- it is a misnomer, as I see it -- there is no intention to build up a huge fund. That is not the intention at all. It is a relatively small amount. We do not expect large surpluses. Our friends are more hopeful, and I hope they are right. But if we happen to have any money there we want to use it in that way.

Now, I would further say this: We have no right today, as I understand the Canadian National Railway set-up, to make expenditures for capital additions and things of that kind without the authorization of Parliament. We must go every year with our capital expenditure budget and have it approved. We are not asking that that restriction be removed. We are not asking to have the fetters taken off in any way in that respect. We are still content under section 21; if we want to build a branch line we have got to go and get express approval, and each year, and next week or the day after tomorrow I think Mr. Cooper is to go over there with his budget, and any additions and betterments of a capital nature have to be submitted to Parliament and approved by Parliament before we can make them. We are not asking that that be removed at all, but we are simply saying the basis of the Canadian Pacific's requirements are reflected in the rate, and if there is anything left by way of a surplus, then we should be allowed to dispose of that surplus in what seems a prudent business management way, as



Mr. Gordon termed it:

"Prudent business management and judgment have always approved the establishment of reserves in years of financial prosperity for use in the leaner years."

Unless the railways are to be kept absolutely flat, without anything in the till to come and go on, then it does not seem to me unreasonable to make this suggestion.

Now, this surplus that Mr. Frawley referred to -- if he had gone on to the next page of the judgment he would have seen there a whole list of cases in which surpluses of 2 per cent on the total value of the company's plant, 2 per cent . . . surplus on the average capital stock, 2 per cent on the capital investment -- any number of variations for a reasonable surplus.

Now, this surplus of \$13 million that Exhibit 246 shows, as Mr. Cooper points out, even if we had the \$13.6 million, it is three quarters of one per cent. We are talking about relatively trivial sums, and I think possibly the Chairman was right when he indicated that it might be well just to forget the whole thing.

THE CHAIRMAN: You see, Mr. O'Donnell, as I view it, if we should accept and adopt the proposals contained in your brief and expounded by Mr. Gordon as to your capital structure, that would require legislation, would it not?

MR O'DONNELL: Yes, my lord; the part as to the adjustment of the capital debt, that would require legislation, yes. The other is merely a request for a recommendation.

THE CHAIRMAN: Well, just a moment. This section 10 that you refer to is the other statute about capitalization.

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: In 1937.





MR O'DONNELL: It deals with surplus or deficits, both.

THE CHAIRMAN: Now, the point is this: Are you just to leave that statute there to carry on, except as the new statute may vary it?

MR O'DONNELL: Yes.

THE CHAIRMAN: Would you not require a new statute which would provide, among other things, what you are to do with a surplus when you have one?

MR O'DONNELL: I do not think we need it today. That would be a restriction of our power, wouldn't it?

THE CHAIRMAN: Well, today you are told first what a surplus is. It says that in the first place it is certified by the auditors appointed by Parliament, and it shows surplus earnings after the payment of all charges including interest on securities held by the public. Now, that is all -- all charges including interest on securities held by the public. Whatever you have over and above that is surplus, isn't it?

MR O'DONNELL: We take it up the hill and hand it over.

THE CHAIRMAN: Everything over that is surplus, and you may or may not pay part of that surplus or the whole of that surplus to the Government.

MR O'DONNELL: The practice has been that we do.

THE CHAIRMAN: So far as I can see, you may use the whole or part of it, just as any other company.

MR O'DONNELL: Absolutely.

THE CHAIRMAN: Payment of all charges including interest on securities held by the public. As I said, I think you are disposed to accept that proposal, Mr. O'Donnell. All this had better be gone into, I think.

MR O'DONNELL: I am very glad to do that, my lord.



THE CHAIRMAN: That is, the bearing of present legislation upon your proposal, and the kind of legislation that would arise if your proposals are accepted. You have heard what Mr. Evans has been saying as to what you should do with your money before you do have a surplus.

MR O'DONNELL: Well, under that statute---

THE CHAIRMAN: Equity stock---

MR O'DONNELL: And who owns the equity? The Government. And who gets any surplus there is? The Government. It is a hundred per cent pay out as far as I am concerned, on the practice that has been followed to date; it is a hundred per cent pay out.

MR MACPHERSON: There is another question, of course, and that is the question I want to know about: Who pays the freight, and what effect does it have on the payment of freight? This is just something new. What we fear, very frankly, is something new, a new fund that is going to be created. My friend says he is not asking today that the C.N. be the yardstick; that is, he is not asking as of today, at this time. The thing is a bit indefinite.

THE CHAIRMAN: I know it is.

MR O'DONNELL: Do you want us to be the yardstick?

MR MACPHERSON: I am saying at the moment that I do not know what you are going to be, and so far as this particular proposition of yours is concerned, I think I see in that that which will ultimately mean a greater request from the freight payer.

MR O'DONNELL: Well, that is certainly not my understanding, Mr. MacPherson. If you have any fear of that kind, I am quite happy -- at least, I would think that the people who are directing your railway, which you own, and the farmers own, and everybody in the country owns, will be very happy -- to meet your views on that. I do not think



that the intention was to do anything other than to try to run this company on a business basis, and in the fatter years to take a little bit for the leaner years.

THE CHAIRMAN: It seems to me that what you have in mind here is some money which will enable you to carry on---

MR O'DONNELL: Without asking for an increase.

THE CHAIRMAN: On rates which have become too low.

MR O'DONNELL: That is right, no question about it.

THE CHAIRMAN: And Mr. Evans is afraid of it for that reason, and Mr. Frawley and Mr. MacPherson are afraid of it because they think it may lead to a fund which in course of time would be looked to as a fund that must be supplied out of the rates.

MR O'DONNELL: That is not my intention. On my basis, at least the C.N.R. basis, there is no intention to ask for any greater rate than prevails today, and if we can save something out of it, that is what we are---

THE CHAIRMAN: Haven't we had enough of it now for today?

MR O'DONNELL: I think so, yes.

THE CHAIRMAN: We would just be beating the air from now on.

Now, is that satisfactory to you, Mr. Evans, to let Mr. O'Donnell come back here with a more definite proposal?

MR EVANS: I think he should.

THE CHAIRMAN: I mean without going on today, unless you feel that you have to. Mr. Fairweather has been here, warming up for---

MR EVANS: Well, I would like to get this cross-examination done. I would prefer to finish it. I may





point up some other questions---

THE CHAIRMAN: But remember, we adopted a rule at the very beginning that anybody coming along with a case to propose could say, "Well, now, we have another witness who is going to answer these questions better than the one in the box," we were to abide by that, and we have done so far.

MR EVANS: I have no objection to leaving the stabilization fund aside, if that is what your lordship is suggesting.

THE CHAIRMAN: That is all I have in mind.

MR EVANS: Oh, I have no objection to that.

THE CHAIRMAN: The disposal of surplus earnings.

MR EVANS: I am quite prepared to do that.

THE CHAIRMAN: Leave that aside?

MR EVANS: Yes. I hope it will be understood, sir, that if and when the proposals are made I can still come back and have Mr. Cooper here.

THE CHAIRMAN: Oh, of course, because we are just as much concerned as you are about the proposal.

MR EVANS: Q. On the question of the earning power for the future, Mr. Cooper -- and in that connection I want to ask you to consider with me two sheets of an exhibit which I have called restatement of results with recapitalization plan in effect from January 1, 1940, on two bases. Now, with that before you -- and before I ask you any questions about it I want to leave this thought with you, because I know that you felt in your answers to Mr. Covert that a statement of this kind would be unrealistic, and I want to lay the foundation for it with you in preliminary discussion before I examine you about it. With that in mind, then perhaps you would deal with the questions that I have to ask you. During the war



years, Mr. Cooper, we had what up to that time was an unprecedented volume of traffic?

A. Yes.

Q. Since the war years there has also been what might be considered an unprecedented volume of peacetime traffic?

A. Yes.

Q. Now, I have in mind, and I am going to suggest this to you, that the traffic volume of the Canadian Pacific, which I think very largely was duplicated by the Canadian National, in the year 1948 measured in revenue freight ton miles was only exceeded in two years of the war. I suggest to you that those years are 1944 and 1945?

A. Did you say 1948?

Q. 1948 was exceeded by three years, namely, 1944, 1945 (which were war years), and the year 1947, which was a post-war year?

A. Measured by ton miles?

Q. Measured in revenue freight ton miles. This is already in the record, Exhibit 188. The revenue freight ton miles in 1948 on the Canadian Pacific were 25,218 million, in 1944 they were 27,375 million, in 1945 they were 27,251 million, and in 1947, slightly in excess of 1948, at 26,201 million revenue freight ton miles. Now, taking the figure of gross ton miles in transportation service, the same exhibit shows that for the Canadian Pacific the gross ton miles in transportation service were in 1948 70,054 million, and that was exceeded only in those three years 1944, 1945 and 1947. Now, I think you will agree with me that, while I have not got the figures for 1949, and there was some drop in volume of traffic in 1949, measured in terms of revenue freight ton miles or gross ton miles 1949 would be at least as high as the average for



the war years. Would you agree with that?

A. The average?

Q. The average for the war years?

A. Yes.

Q. Now, I think it is equally clear that during those war years the Canadian National was able to earn substantial surpluses?

A. Yes.

Q. Now, I want to suggest to you that, apart from the acquisition of the Newfoundland Railway and the Temiscouata, which I am quite prepared to leave aside for the moment -- and I won't forget, I promise you -- the position of the two railway companies today in relation to the volume of traffic is only worse, because of an imbalance between rates and costs, than it was in the war years?

A. As far as the Canadian National is concerned, that is the situation, I believe, that the immediate difficulties as opposed to the long-term difficulties result from the imbalance between increased costs and increased expenses.

Q. I am not asking you to go all the way with me yet. I am just asking you whether, apart from the acquisition of the Newfoundland Railway -- which I quite concede is a special consideration, and we will come to that -- and the Temiscouata, the position today measured in terms of traffic volume would, but for the imbalance, enable the Canadian National to earn substantially the wartime surpluses?

A. I should say so, yes; I would agree with that.

Q. Now, as for the future -- I think we need not get far apart on this, either -- as for the future, there will be declines and there will be upward trends in traffic; but would you agree with me to this extent, that there is a relation -- I am not asking you to say





what relation, but there is some relation -- between population and traffic, on the average?

A. As a generality, yes.

Q. Well, that is all I am asking. Now, as the population of Canada increases, the trend -- I am speaking now of average traffic volume -- the trend ought to be upward in traffic?

A. Apart from competition, yes.

Q. I want you to make that reservation, because I have it in my own mind. So the trend should be upward, apart from competition?

A. Yes.

Q. Now, I suggest to you that it is not improbable that even with declines from time to time you will have in terms of traffic volume years as good as those years like 1949, 1948 and the war years -- in terms of traffic volume?

A. In the immediate future or---

Q. I am saying in the future; I do not care whether it is the immediate future or the far distant future.

A. I would agree with that.

Q. So that on the assumption that this imbalance is corrected as between rates and costs, I am suggesting to you a distinct probability that, as time goes on, and assuming the imbalance is corrected as it should be, the conditions which gave rise to the wartime surpluses of the Canadian National are quite probably going to arise in future?

A. When you say the imbalance is corrected, do you mean in its entirety?

Q. As between rates and costs -- I do not mean every dollar of increased cost should mean increased rate; I mean the imbalance in the sense that we have been discussing it, that so far as is necessary to provide needs or



fair return the rates will be increased?

A. Before I answer that question, allowing for all the increases which have taken place -- I am speaking now of the 8 per cent last October and the recent one -- those things in full effect, we are \$46 million to the bad on the imbalance account. Now, my question is, to what extent is the \$46 million going to be adjusted? I said in its entirety, and you said, well, not to the last dollar, but---

Q. I am sorry; I misunderstood you. May I get at once on a common basis with you. When I spoke of imbalance between costs and rates, I thought I was speaking of the same thing you were, that is to say, that the imbalance or the extent of it would be measured, not by the actual dollar increases in costs so much as the proper earning power of each of the railway companies. That is to say, if you had a proper earning power established -- you would have to give effect to traffic volume -- the imbalance would be restored when the rates were such that the earning power that was permitted had been established. Have I made myself clear to you?

A. I am afraid not.

Q. Well, let me put it to you this way: In the case in which you put some figures on the record you showed the extent to which the increased costs of labour and materials have been met as a result of freight rate increases?

A. Yes.

Q. Now, I think it would be agreed that it would not necessarily require freight rate increases to restore the balance represented by the increase in dollar costs of labour and materials?

A. You mean to completely equalize the additional cost?



Q. Yes. Supposing you had increased costs of \$100 million a year, it would not follow automatically that you had to have \$100 million of increases in freight rates?

A. That is the point I was trying to get from you: To what extent is this margin to be perpetuated or brought into agreement? We started off in 1949, as I said, with increased costs of \$180 million, against which we had increased revenues of \$101 million, so we had an imbalance of \$79 million, and against that we have had about \$33 million of additional revenue by increases which were not in full effect during 1949. So we are still \$46 million short of being compensated for the additional costs.

Q. I think I understand you now; I did not before. At all events, when we speak of imbalance we mean the amount by which rates are short of meeting what you should be getting?

A. Yes.

Q. That is all I mean by imbalance. I do not mean dollars of increased cost necessarily. Now then, I suggest to you that this imbalance ought to be restored?

A. I agree with you.

Q. Or redressed?

A. If the economy of the country will stand it, I agree with you.

Q. Now, if you put that qualification in there, I think I am bound to ask you this: At least so far as the Canadian Pacific is concerned, and if costs are rising, usually prices and national income are rising; is that not likely to be true -- and quite apart from this question of competition? Are you suggesting that the country cannot afford the Canadian Pacific?

A. No, I am not suggesting that at all.

Q. Then perhaps I misunderstood your qualification.





A. And I am not asserting it. I say provided the economy of the country will permit, then I would agree that the imbalance should be adjusted by increases in rates.

Q. Well, you are not by that qualification suggesting that you have views that the economy of the country cannot afford---

A. No, I do not say it cannot. On the other hand, I do not assert that it can.

Q. Well, as long as we understand one another; but it is no part of your assertion that it cannot at the moment. Now, assuming that that imbalance is restored, I suggest to you -- I am not asking you to say that it is going to happen, but I suggest to you that there is at least a probability that, having regard to the two factors of growth in population and the necessity for restoring the imbalance of which we have been speaking, the Canadian National may expect in some years surpluses at least as high as in the war years?

MR O'DONNELL: What year will that be?

MR EVANS: I am not specifying, Mr. O'Donnell. I have reserved two things; Mr. Cooper can reserve those, too.

THE WITNESS: I agree with you, Mr. Evans, that if this imbalance is removed, if there is some equilibrium established between increased costs and increased revenues, the Canadian National Railway would in years of high traffic volume have reasonably good surpluses.

MR EVANS: Q. I was hoping perhaps you would go a little further with me. You would have probably in some years surplus of the magnitude that you had during the war years?

A. I question that very much. In 1943 we earned 26½¢ out of every dollar after we had paid our operating



costs. In 1949 we earned  $4\frac{1}{2}\phi$  out of every dollar.

Q. Well, there was a period of imbalance, though?

A. Yes. You are suggesting, though, or you were putting it to me, that there was some expectation that the  $4\frac{1}{2}$  would be put back to the  $26\frac{1}{2}$ . I will agree with you that if we ever get to the point where we can take  $25\phi$  out of every dollar of gross revenue and keep it after paying all our expenses, yes, we shall have some surpluses.

Q. Well, I am speaking now in terms of traffic volume. I think you cannot really assess operating ratio except in terms of traffic volume, and I wanted to get on a basis where traffic volume in these few years -- perhaps you cannot name them, but I am suggesting the possibility that there would be a few years where you would have at least as much traffic volume, and therefore, with the imbalance redressed, at least as much net. Now, that is all I am asking you, to envisage the possibility. I am not asking you to specify the years. I am leaving out -- and I am going to come back to them -- the Newfoundland Railway and the Temiscouate and this question of motor competition. All I suggest to you is that in future it is not improbable, and in fact I would suggest to you exceedingly probable, that those conditions will again be met in some years?

(Page 1903<sup>5</sup> follows)



A. Well, I like your optimism, Mr. Evans. I am probably a little more conservative in my outlook than you are. I cannot quite visualize ever a return to what we might call the prosperous years of war. Even if we had another war, even if our traffic volume in the next decade were higher than it was during the war years, I don't believe that we would make the same surpluses which the Canadian National did make in World War 2. I don't think that would ever happen again.

COMMISSIONER INNIS: Possibly the toleration point of surplus earnings from the standpoint of rate cases, Mr. Evans.

MR EVANS: That is exactly the thing I want to get to, but I wanted to point this out from this standpoint, that if there is a possibility (and I would not even have to go beyond the possibility) then where do the earnings go if they are earned, and ought not they to go to the equity capital holders? I don't think I have to go beyond that. I am no better forecaster perhaps than Mr. Cooper, or perhaps not half as good.

THE CHAIRMAN: When you say they ought to go do you think they ought to be compellable to go?

MR EVANS: I think they should in protection of the Canadian Pacific because if they go into a rate stabilization fund ( and I have an Exhibit I am going to file in just a moment) if they go into a rate stabilization fund, you have these conditions. I want to demonstrate - and I am sure that the witness is going to have some reservation and I don't want to be unfair about it - but I am going to demonstrate I think, that the fund in those circumstances for rate stabilization purposes might grow to very substantial proportions under the proposal. That





is the purpose of this Exhibit which I have been leading up to and I am about to put in.

THE CHAIRMAN: Well, I think we had better come back to it.

---RECESS

---ON RESUMING

MR O'DONNELL: May it please the Commission, we promised that as soon as the Annual Report was tabled it would be forthcoming. I am informed that it was tabled at 3:15 and the messenger fought his way through the snowstorm to get it over here. I plan therefore to produce it as Exhibit 254. I promised to give it to the Commission as soon as it was available, and I wanted to keep my word.

---EXHIBIT 254:

Annual Report of  
Canadian National  
Railways for 1949.

MR EVANS: Before I proceed directly to these two tables that I have supplied to you a day or so ago, I want to put on the record the figure of gross ton miles of the Canadian Pacific in 1949. The figure for 1948, the Commission will remember was 70 billion odd. The figure for 1949 was, 69,519 million. According to the calculation made from Exhibit 188, that figure exceeded the average for the years 1939 - 1948 inclusive by a little over 9%. So that what I am suggesting is that on the basis of 1949 there was a traffic volume measured in gross ton miles in excess of the average for the years of the war and the post-war years.

Q. Now, then, Mr. Cooper, I have expressly reserved in my discussions with you the effect of the Newfoundland railway, and I understood you to say that the opinion of the Canadian National was that the assumption



of the reponsibility of managing that railway and the incorporation of that railway in the accounts of Canadian National, would result in \$4 million per annum deficit.

A. That is the minimum, yes.

Q. Now then, I have not frankly allowed for that figure in this statement and I am going to ask you about the statement, first eliminating that and then including it. I f you will turn to one which I would like now to have numbered as Exhibit 255, that is the statement headed "Re-Statement of Results with Recapitalization Plan in effect from January 1st, 1940". For your information, Mr. Cooper, the one which I am asking to have numbered 255, is the one in which in the third line from the bottom of the table the words "Deduct amount equal to capital expenditures" appear.

---EXHIBIT 255: Filed by  
Mr. Evans:.

Statement entitled:  
"Re-statement of Results  
with Recapitalization  
Plan in effect from  
January 1st, 1940".

Now then, I suggest to you that apart from this Newfoundland Railway deficit which the Canadian National has to assume,

(Page 19038 follows)



that if the proposal which you have made to this Commission had been given effect to as of January 1, 1940, and if there had been taken first out of the surplus all of the capital expenditures of the Canadian National, leaving the balance of the surplus for the rate stabilization fund, then there would have been in the fund, as at the end of 1946, an amount of approximately \$185 million.

A. That is what your statement shows.

Q. Yes, that is what the statement shows, and assuming that the statement is right, I will let you go back to it.

A. I do not think I could make that assumption.

Q. I do not ask you to. Perhaps you would like to make your qualifications now?

A. First, you are assuming that the entire surplus, after capital expenditures, goes into the fund?

Q. Yes.

A. Now, we said this morning that we did not think that was necessarily going to be the case.

Q. Yes. Of course, when I prepared this, you will understand, I had no advance knowledge of that nor have I at the moment anything to indicate that it <sup>is not</sup> at least within the power of the Canadian National, under the proposal, to put all the money into the fund?

A. Well, at any rate, you are assuming that all of the surplus, after capital expenditures have been made, will go into it. That is one assumption.

Q. Yes. Let us assume that. Would you then have any quarrel with the result obtained as at 1946?

A. If it is intended to give an indication of what might happen in a similar period of time, after the





beginning of a stabilization fund arrangement, then I would say that the whole premise behind that assumption is in error.

I do not believe for one minute, as were saying just prior to the recess, that we may have a recurrence of the surplus earnings of the Canadian National which we enjoyed in the war years.

Q. I understand your reservation. But I am putting this to you rather on the basis that I put to you the probability or possibility of some increased traffic volume in future years which might parallel the results of the war years, and also assuming the imbalance between rates and costs restored.

I am not asking you to say that that is what would have been the case in those years. All I am asking you to do is to check with me first, that if that should occur, and if this proposal should have approval, that that result would obtain, if that series or sequence or years and traffic volume should be experienced?

A. The same number of years?

Q. Yes.

A. The same traffic volume?

Q. Yes.

A. The same rates?

Q. Yes.

A. The same costs?

Q. Yes.

A. And the same balance between costs and rates?

Q. Yes.

A. Well, subject to the expression of a strong conviction on my part that almost all your assumptions are



false, then I am prepared to say that we would arrive at the figure of \$185 millions, the figure you were speaking to.

Q. Yes.

A. But please do not <sup>get</sup> me as giving the slightest credence to the implications or the assumptions which are built into this statement.

Q. I think that is fair: that you disagree with me that there is a probability of that condition being met with in the future?

A. That would be my conviction.

Q. Yes, and I quite respect it.

I am suggesting to you that in the future there was the possibility of that happening again.

I think all I have to put to you is the possibility.

Now, if that should happen, and if these things should come to pass, it would, perhaps--then assuming all the money after capital expenditures goes into the rate stabilization fund, it would emerge as at 1946 on this statement, at the figure of \$185 million, or approximately that amount?

A. Yes, however I still do not understand why you would not go on to 1947, 1948, and 1949.

Q. I am going on. And the reason I picked 1946, to be perfectly frank with you, was that in that year we made application for the 30% increase. Both railways joined in that application, in October 1946.

Now, at that time, if there had been in the stabilization fund \$185 million, I ask you, as a senior accounting officer of the Canadian National: What do you think would have been the reaction to an application, by the Canadian National,



for an increase in rates at that time?

A. If the Canadian National could see what was going to happen in the next year, in 1948, I think they would have joined in the application.

Q. Yes. Now without asking you to express an opinion about what might happen elsewhere, do you not agree that there would have been very substantial pressure on you to avoid joining in an application for an increase under those conditions?

A. I think your questions now are highly hypothetical.

Q. Well, your Brief rather suggested it.

A. No, sir, I do not think there was anything in our Brief which suggests that after meeting our capital expenditures to the extent that they are set out here, we could hope to have surplus earnings over and above that in a period of six years time of \$185 million.

Q. I know your reservations and your feeling that that conditions could never occur, but I am merely suggesting to you that your Brief rather did suggest that: Had the Canadian National had a substantial surplus in the period 1925 - 1929 - and I am looking at page 38 where at the very bottom of the page you say:-

"Applying such an adjustment of \$20 million surpluses would have been enjoyed during the years 1925-1929 inclusive reaching a high of 23 odd million in 1928."

That is at the very bottom of page 38 of your Brief?

A. Yes.

Q. Then it goes on to say:-

"In these circumstances lower freight rates following pressure for downward revision





would probably have very considerably reduced if not entirely eliminated such surpluses."?

THE CHAIRMAN: Pardon me, but I am unable to find it.

MR. EVANS: I am reading starting at the bottom of page 38 and going on to the top of page 39 of the Canadian National Brief.

THE CHAIRMAN: Oh, yes.

MR. EVANS: Q. And you say, further down, on page 39:-

"Again, had the adjustment been applicable, the surpluses which would have been earned in the years 1940 to 1947 inclusive would also have been required to off-set the losses in other years. Lacking wartime control of wages and material prices, it is extremely doubtful that such surpluses could have been amassed. In addition, as already indicated, the Canadian National would have been hard put to maintain freight rate levels."

My suggestion to you about that is this: that, with the condition which we have agreed is hypothetical, where the Canadian National in 1946 might have had \$185 million in the rate stabilization fund, -- in view of those two statements in your Brief, do you not agree with me that it would have been exceedingly difficult for the Canadian National to have resisted pressure designed to prevent an increase in freight rates that year?

A. Do you suggest that at that time the Canadian Pacific yardstick would have been set aside?



Q. Well, in suggesting this to you: that the pressure would have been very great indeed to set us aside and to bring pressure about not to join in a rate increase but to draw upon your fund - -

A. Well, if every<sup>one</sup> of your assumptions were real, I imagine something of that sort would have happened.

Q. That is all I expect you to do. I do not expect you to agree with everything I say.

I merely suggest the possibility that that might happen; and so I go on to 1948, the year in which the 21% increase became effective; and the first column of 1948 is the column which reflects the effect of the 21%<sup>increase</sup> which was ordered on March 30, 1948.

And as of the end of that year, the fund, on the same assumptions, and subject to the same reservations, would still have had about \$107.7 millions in it.

Now then, in July of that year with the fund at that level, an application was made by the railways for a further increase in freight rates.

Do you not think that much the same difficulty would have been experienced at that time as you, perhaps, might agree would have been experienced in 1946?

A. Well, I have gone about as far as I think I should, Mr. Evans.

Perhaps in fairness to Mr. Covert I should say to you now that I think your statement is so unrealistic that I do not see any particular point, and I doubt whether you should press me.

Q. Oh, I do not want to embarrass you. I want you to understand that, without attempting in any way to embarrass you and without assuming that the Canadian National



has any ill will to the Canadian Pacific, I suggest to you that the position of the Canadian National just might be that despite your desire not to be the yardstick, that pressure might be brought to bear to make you the yardstick. That is what I am suggesting, and not any ill will.

A. No. If I knew what use you were going to put to any admission which I might make, even on your assumptions, I might speak a little more freely.

But I am somewhat in the dark and I am not going to go too far. I have met you part way and I think I should stay where I am.

Q. I am not going to press you unduly.

COMMISSIONER INNIS: Are you going to go on to the question of labour?

MR. EVANS: I have one question on that.

MR. EVANS: Q. Exhibit 255, I would draw to your attention, has taken out of the surplus before the fund all of the capital expenditures in that year; and I was going to ask you whether you thought perhaps Mr. Fairweather might answer me this: It would be fair to consider that all these capital expenditures were in this non-revenue producing category?

A. Oh, very definitely not.

Q. No. And therefore would it be fair to say this: That Exhibit 255, so far as the use of surplus for capital purposes is concerned, is not ungenerous to the Canadian National?

A. No, it is not ungenerous; but I would, of course, quite expect with surplus earnings of that order, that all our capital expenditures would be met before anything was put into the surplus.

Q. Yes. You would expect this fund - I mean the





surplus Item (a) in this surplus to include all capital expenditures whether non-revenue producing or revenue producing?

A. In such a situation as this statement predicts?

Q. Yes; so actually that would be different from the proposal, because as I recall the proposal, it was only that these capital items which were non-revenue producing were to come out of that surplus.

A. On that my view would be that all capital expenditures, that is, all improvements and betterments should come out of the surplus earnings.

Q. Whether non-revenue producing or not?

A. That would be my thought.

Q. Yes, but I can only take it on what the proposal of Mr. Gordon was, and I have prepared an alternative Exhibit which was exactly the same as the previous one, showing what would happen if half of the capital expenditures in those years was taken out as non-revenue producing, and the balance went into the fund.

A. Yes.

Q. And I am going to go through that in detail with you. You see that it does have a material affect on the resulting funds in the rate stabilization fund.

This alternative statement will be Exhibit 256, and it is exactly the same as Exhibit 255 except that the deduction for capital expenditures for surplus is taken at one-half of the actual expenditures in each year, instead of, as in Exhibit 255; and on that basis, as the Exhibit shows, and always subject to the reservation which Mr. Cooper wants to make, and on the basis of my assumptions, the fund would have reached \$255.4 millions



in 1946, and as at 1948, it would still be \$222 million.

...EXHIBIT 256...filed by : Canadian National Rail-  
Mr. Evans : ways Statement of  
: Results with Recapitaliza-  
: tion Plan in Effect from  
: January 1, 1940.

MR. EVANS: Now, I have just one further statement I would like to put in, Mr. Cooper.

May I file as 257 a statement entitled "Canadian National Railways Net Income Results - Year 1949 (Restatement of Exhibit 246).

...EXHIBIT 257....filed by : Canadian National Rail-  
Mr. Evans : ways - Net Income Results  
: Year 1949. (Restate-  
: ment of Exhibit 246).

MR. EVANS: Q. I understand you have had this statement in your hands for some little time?

A. Not for very long.

Q. But the first two you had a couple of days ago.

A. I know the differences between your statement and mine.

Q. I am not going to shy away from those differences. Now, to come back to Exhibits 255 and 256, it is only fair, I think, to point out to you that if you had had the Newfoundland Railways throughout that period, and taking \$4 million as the annual deficit, it would have reduced the surplus earned in those years - that is the surplus as of 1946 instead of being \$185 millions would have been about \$161 millions.

A. I assume that is one of the assumptions.

Q. I wanted to be fair to you and say that the statement did not include that; and I wanted to make sure that we understood one another, and that the Newfoundland



Railways had been taken over in 1948, that would have been \$4 million a year cumulatively through all those years.

I did not adjust it for the Temiscouata, but that is a relatively small amount.

But in 1948, instead of - on Exhibit 255 - instead of it being \$107.7 million, it would have been only \$75.7 million. You can check me on that and if I am wrong, I would be glad if you would correct it.

A. Frankly I do not think the statement is worth checking.

Q. I would not want to be too sure there is no point to it. I have been trying to be fair with you about it.

MR. O'DONNELL: Q. You said that, Mr. Cooper, because you think it is unrealistic?

A. Yes.

MR. EVANS: Q. Turning now to Exhibit 257, I think Mr. Cooper has said that he was familiar with the differences between Exhibit 246 as filed by him and our restatement of it which appears in Exhibit 257.

I want to take you at once to the differences. The first difference is that in Exhibit 246 you had made an adjustment of the 1949 results on the assumption that the 16% increase in rates awarded on March 1 and effective March 23 had been in effect for the full year?

A. Yes.

Q. And our restatement of that assumes that the 16% should have been 20%, and that the increase had been in effect for the full year, 1949.

A. That is as I understand your statement, yes.

Q. That is the first difference?





A. Yes.

Q. Now, the other difference is the elimination of what you have called in Exhibit 246, that is, the amount of \$8 million, which you called the elimination of special credit from the deferred maintenance reserve.

Am I correct?

A. Yes.

Q. Apart from that, there are no other differences?

A. No.

Q. Now, with regard to that difference of \$8 million, am I correct in saying that the net income deficit of \$42,043,000 represents the deficit experienced after giving credit for expenditures for the amount drawn down from the deferred maintenance fund?

A. Yes.

Q. And that therefore, as I understand your evidence of yesterday, since you were of the view that the maintenance level done in 1949 was not above normal, that the deficit really understates the two deficits; is that fair? If not, I want you to correct me.

A. Yes.

Q. Now then, the assumption of \$8 million which you have made in Exhibit 246 is, in effect, but a restated deficit on the assumption that there had been no draw-down from the deferred maintenance fund?

A. That is correct.

Q. Now then, in order to get on a basis comparable with the Canadian Pacific, I suggest this to you: That as was disclosed in the evidence before the Board of Transport Commissioners a few weeks ago, the Canadian Pacific were also of the opinion that its maintenance



expenditures were not above normal, but that notwithstanding that, they drew down from their deferred maintenance to the extent of approximately \$7-1/2 millions. Do you recall that?

A. No. In 1949 you say?

Q. In 1949. What I am really trying to do - I am not quarrel/<sup>ing</sup> with you about your view as to the level of maintenance and the propriety of the item; but my purpose in eliminating it from Exhibit 257 was: that if we want to make a comparison with the Canadian Pacific, we should have exactly the same view concerning its maintenance, so we could perhaps forget the \$8 million, for purposes of comparison.

A. But this statement is not for the purpose of making a comparison with the Canadian Pacific. This statement is entirely related to the Canadian National Railways and has nothing whatever to do with the Canadian Pacific.

It is an attempt to show what the real surplus of the Canadian National would have been in 1949 if all these freight rate increases had been in effect.

Q. Yes.

A. And if the proposals of our President had been made effective.

Q. Yes.

A. And it is not intended, in any shape or form, for comparative purposes with the Canadian Pacific. And the reasons which impelled you to use your deferred maintenance reserves do not have any bearing on the position of the Canadian National, in my opinion.

Q. I am sorry if I have made myself misunderstood.

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I am not saying that you offered Exhibit 246 for comparative purposes. But I offer Exhibit 257 for comparative purposes, and I thought it only fair to say that the \$8 million, for comparative purposes, might be eliminated, because substantially the same amount was involved in both railways for that year.

A. I might say that the Canadian National has made a statement of what they think their surplus should have been in 1949 on the assumptions which I mentioned.

MR. O'DONNELL: You are referring to Exhibit 246?

A. Yes, sir.

MR. EVANS: Q. I am not quarrel<sup>ling</sup> with you about that.

A. But I cannot see any point in what you are saying, unless you are contending that I <sup>eliminated</sup> that \$8 million improperly.

Q. Oh, I do not!

A. Then you agree that as far as my figure of \$13 million is concerned the connection with the book surplus of \$8 million was correct?

Q. I will say this: that the purpose for which you intended it was to test the 1949 results according to the facts as they were.

Now, what I would like to do is this: I will either leave your \$8 million in and put a similar adjustment in the Canadian Pacific results, or I will leave it out of both, which I think is the fairer, and restate your Exhibit on the basis of that adjustment; for instance, what is common to both, I will leave out of both; and then





taking it on the assumption that the 20% increase which we all applied for had been in effect for the full year, I suggest this to you: that on the basis of 1949 as restated, and assuming that the 20% increase in rates had been in effect, the Canadian National would have this adjustment in its capital structure, and that it would have had a surplus of \$29,223,000; and on the same basis, the Canadian Pacific would have had, over its requirements, a deficit of about \$1 million .

A. Well, frankly, I think we are talking at cross purposes. I have no figures in keeping.

Q. Well, I am going to give them to you.

THE CHAIRMAN: . You had better give them to us tomorrow. We shall adjourn now until the morning.

---At 4.45 p.m. the Commission adjourned until tomorrow, Friday, March 24, 1950 at the hour of 10.30 a.m.













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